No. 10,550

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

THOMAS H. WINGATE, as Receiver in Equity for Pacific Empire Holdings, Incorporated (a corporation of the State of Delaware),

Appellant,

vs.

PETER BERCUT, HENRI BERCUT, M. MAFFEI and L. R. ARNOLD,

Appellees.

APPELLANT'S OPENING BRIEF.

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Part I.

INTRODUCTORY STATEMENT.

This is an appeal from a judgment of the United States District Court for the Northern District of California, Southern Division, denying to plaintiff any of the relief sought by his complaint and awarding judgment in favor of the defendants Peter Bercut and Henri Bercut against plaintiff for the delivery of 308⅔ shares of preferred and 3522 shares of common stock of Merchants Ice and Cold Storage Company, a California corporation, and the payment of $3850.

The action is brought by the Receiver in Equity of Pacific Empire Holdings, Inc., a Delaware corporation.

The defendants Peter Bercut, L. R. Arnold and M. Maffei, are alleged to have been the managing officers and directors of Pacific Empire Holdings, Inc., and of its subsidiaries, Pacific Empire Corporation, Merchants Ice and Cold Storage Company, and California Pacific Service, Inc. at the time of the purported transfer of personal property hereinafter referred to, and defendants Peter Bercut and Henri Bercut are the transferees of the property involved in the suit.

Plaintiff contends that the pleadings and evidence of the case warrant only a judgment in favor of plaintiff as prayed for in plaintiff's complaint, and by this appeal it is sought to obtain from this Honorable Court a judgment reversing the decision of the trial Court and directing it to enter judgment in favor of plaintiff as prayed for in plaintiff's complaint.

The suit is maintained in a representative capacity for the benefit and protection of Pacific Empire Holdings, Inc., its stockholders and creditors, under and pursuant to the authority vested in the Receiver by Section 4408 of the Revised Code of Delaware of 1935.

Part II.

JURISDICTION.

The jurisdiction of the Court over the cause is based upon diversity of citizenship. The amount in controversy exceeds $3000. The jurisdictional facts appear on the face of the record. (Complaint: opening allegations and paragraphs I, II and III of first cause of action, R. 2; Finding I of trial Court, R. 941.)

The right of plaintiff to maintain the action is an admitted fact of the case (R. 294) and so found in finding II of the trial Court. (R. 941.)

The original jurisdiction of the District Court is sustained by 28 U. S. C. A. 41 (1).

This Court has jurisdiction on appeal under 28 U. S. C. A. 225 (a), (d). Appeal was taken within the period of three months allowed by 28 U. S. C. A. 230. Judgment was entered August 9, 1943. (R. 956.) The order denying motion for rehearing and new trial is dated August 9, 1943. (R. 959.) Notice of Appeal was filed August 13, 1943. (R. 960.) The time did not expire until November 8, 1943. (28 U. S. C. A. 230.)

Part III.

A BRIEF STATEMENT OF THE FACTS OF THE CASE AS DISCLOSED BY THE TRANSCRIPT OF RECORD.

For the purpose of brevity and clarity, hereafter in this brief, Pacific Empire Holdings, Inc. (a Delaware corporation) will sometimes be referred to as "Holding Company"; Pacific Empire Corporation (a California corporation) will sometimes be referred to as "Empire Corp."; Merchants Ice and Cold Storage Company (a California corporation) will sometimes be referred to as "Merchants Ice"; and California Pacific Service, Inc. (a California corporation) will sometimes be referred to as "Pacific Service".

(a) Corporate structure, activities of and control over Pacific Empire Holdings, Inc. and its subsidiaries.

Pacific Empire Holdings, Inc. was originally incorporated under the laws of the State of Delaware under the name of Associated Calitalo Holdings, Ltd., Inc., and thereafter by amendment to its certificate of incorporation duly made in accordance with the law its corporate name was changed to Pacific Empire Holdings, Inc. (R. 65-66.) On January 8, 1941, it had outstanding 2,500,000 shares of common stock owned by approximately 10,000 stockholders. (R. 66.) Its principal activities have at all times been conducted in California.

As implied by its name it functioned as a holding company. (R. 763.) Over a period of years, beginning with about 1930 it acquired the controlling interest in the following corporations: (a) Merchants Ice and Cold Storage Company, a California public utility corporation operating a cold storage and ice manufacturing plant in San Francisco; (b) Pacific Empire Corporation, a California corporation, an investment company which in turn owned a substantial interest

in the Pacific National Bank of San Francisco, a national bank; (c) California Pacific Service, Inc., a California corporation, owning and operating "The Family Service Laundry" in Bakersfield, California.

On January 8, 1941, Pacific Empire Holdings, Inc. owned 65,863 shares of common (out of a total of 107,180 shares of common stock outstanding) and 12,493 shares of preferred (out of a total of 41,615 shares of preferred stock outstanding) of Merchants Ice. It is alleged in the complaint that the reasonable value of this block of common and preferred shares, on January 8, 1941, was and is now not less than $1,000,000.

On January 8, 1941, Pacific Empire Holdings, Inc. also owned approximately 52% of the outstanding stock of Pacific Empire Corporation. The remaining 48% of the outstanding stock of Empire Corp. was owned by approximately 500 stockholders.

On January 8, 1941, it also owned approximately 47½% of the outstanding stock of California Pacific Service, Inc. and the balance of the outstanding stock of this corporation was then owned 47½% by Joseph I. McInerney and 5% by the public. (R. 189.)

In order to insure that control over Pacific Empire Holdings, Inc. would always rest with them, a voting trust arrangement was set up in 1936 whereby defendants Maffei, Arnold, Bercut and the other then acting four directors became voting trustees. (See Pl. Ex. 20, R. 214-216.)

Control over Empire Corp. rested in the Holding Company. Nevertheless a general proxy was solicited

from the other 500 odd stockholders running for several years in favor of defendants Maffei, Arnold and Peter Bercut. (See Pl. Ex. 21, R. 218.)

Under Part I of the Appendix we have incorporated the pertinent sections of the by-laws of the Holding Company in force and effect on January 8, 1941.

(b) The financing and nursing of Merchants Ice by the Holding Company during the depression.

It is undisputed that the investment made by the Holding Company in Merchants Ice and Cold Storage Company was by far its largest single investment. The aggregate investment made by the Holding Company in the acquisition of said shares in Merchants Ice was about $400,000. (See testimony of Maffei (R. 71); testimony of Arnold. (R. 865.) It constituted its principal asset. (R. 239; Pl. Ex. 15, R. 205, 206.)

Merchants Ice, like all other companies of this character, underwent a tremendous shrinkage in business as the result of the nationwide business depression prevailing from 1930 to 1937. (R. 511.)

Because it represented its largest single investment, offering the best promise for the future, the Holding Company concentrated all its efforts and finances towards saving Merchants Ice.

Accordingly, the Holding Company, beginning in 1935, began to lend large sums of money to Merchants Ice to be used for the purpose of meeting

the taxes, bond interest and principal maturities of the latter. (R. 94 and 724.)

In 1935 it loaned Merchants Ice $50,000, which was borrowed by Pacific Empire Corporation from Joseph I. McInerney, and in turn reloaned to the Holding Company, which in turn loaned it to Merchants Ice. (See R. 94, 95; and Pl. Exs. 8 and 9, R. 95-105.)

To secure the loan made by Pacific Empire Corporation to the Holding Company, the latter pledged to the former 49,944⅓ shares of common and 3990 shares of preferred of Merchants Ice and Cold Storage Company. (Pl. Ex. 10, R. 123 and Pl. Ex. 11, R. 128.)

Thereafter, from time to time, the Holding Company made further large advances to Merchants Ice, generally obtained by the Holding Company borrowing from Pacific Empire Corporation or from California Pacific Service, Inc., the laundry company. (Pl. Ex. 9, R. 114; also R. 165-166.) From time to time the Holding Company and Pacific Empire Corporation guaranteed the borrowing of Merchants Ice from Pacific National Bank of San Francisco. (See Pl. Ex. 12, R. 145, 151, 177.) In 1939 Empire Corp. was caused to sell 280 shares of its stock in Pacific National Bank of San Francisco to H. R. Gaither at $125 a share. The funds were thereupon "borrowed" by the Holding Company and used "to help the Merchants Ice and Cold Storage Company". (See

testimony of Maffei, R. 190; see also Pl. Ex. 15, R. 205 at 207; also R. 164-165.)

In 1936 the Holding Company financed Globe Brewing Company, then a valuable tenant and customer of Merchants Ice, by investing approximately $40,000 therein. This investment subsequently became worthless. (R. 113.)

In 1939 it financed Frostkraft Packing Corporation, also a valuable tenant and customer of Merchants Ice. (R. 170-171.)

In 1936 Merchants Ice had outstanding $659,500 of 6½% first mortgage bonds which matured annually at the rate of about $40,000 a year plus interest. Because of the tremendous shrinkage in its business, and other causes, it found it increasingly difficult to meet said maturities even with the financial help given to it by the Holding Company and Empire Corp. So in 1936 Merchants Ice went through a 77-B reorganization wherein and whereby the principal maturity on its outstanding bonds was deferred for a period of five years. (R. 142.)

At no time has Merchants Ice ever defaulted in the payment of any of its obligations or in meeting its bond maturities. (R. 512-513.)

On June 30, 1940, there was mailed to the stockholders of Pacific Empire Holding, Inc., the annual report for the year 1939. *Said report and balance sheets are Pl. Ex. 15, found at R. 205, and set forth in full under Part II of the Appendix to this brief.*

During all of these years the Holding Company made it a policy of buying on the market at the cheapest possible price all of the preferred and common stock of Merchants Ice offered for sale. (See testimony of Arnold, R. 879; and testimony of Maffei, R. 181-182; also R. 204.)

In 1934 the Holding Company purchased 700 shares of preferred of said stock for $11,200 from W. H. Roussel, a director of Merchants Ice. (R. 879.) During 1938 the Holding Company purchased a total of 18,727½ shares of common and preferred. (R. 181.)

In 1939 the Holding Company purchased 5516⅔ shares of preferred of said stock from the estate of Wm. A. Sherman for $7604.68. (R. 163.)

In the annual reports of the Holding Company sent to its stockholders for the years 1937 (R. 137); 1938 (R. 181); 1939 (R. 208) the ownership by the Holding Company of Merchants Ice stock—both common and preferred—showed a continuous increase. By December 31, 1939, the investment of the Holding Company in Merchants Ice was carried on its books at $669,363.47, or practically 70% of all its assets. (See balance sheet, R. 210.)

(c) Aggravation of financial condition and looting of the Holding Company and its subsidiaries.

Beginning with 1937, the financial condition of the Holding Company and Empire Corp. became ever more acute. (R. 175.)

In 1938 it sold its subsidiary, Assured Thrift, (an insurance agency operating in Los Angeles) to Joseph I. McInerney for $13,000. (R. 159.) It had "borrowed" all available assets of Empire Corp. (R. 175.) By December 31, 1939, the liabilities of the Holding Company had increased to over $250,000, of which, among others, $86,019.90 was owing to Empire Corp. (R. 182-183.) *It had "borrowed" all of the assets in the hands of L. R. Arnold,* liquidating agent of City National Bank of San Francisco, a national bank in process of liquidation. *These assets, aggregating $59,373.60, were trust funds in the hands of the defendant Arnold which should have been distributed to the more than 500 stockholders of the dissolved bank. Instead, the Holding Company "borrowed" them for its own purposes* (R. 184-185), with the result that the stockholders of City National Bank of San Francisco, in lieu of the assets taken over by defendant Arnold for liquidation and distribution to them, received a worthless note of the Holding Company. (R. 186.)

By the end of 1939 the Holding Company was in arrear on its rent (for its sumptuous offices at 26 O'Farrell Street) to Kohler & Chase in the sum of $11,637.82. (R. 186.)

On February 15, 1940, there was held the annual meeting of the stockholders of the Holding Company and the following seven directors were elected to serve for the ensuing year, viz.: M. Maffei, L. R. Arnold,

Peter Bercut, A. A. Heer, Jr., Luigi Gracchino, Webb Richards. (R. 182.) The directors on February 15, 1940 appointed M. Maffei, president; L. R. Arnold, vice president and secretary; Peter Bercut, vice president; and an executive committee, consisting of M. Maffei, L. R. Arnold and Peter Bercut. (R. 187.) At this meeting, the following resolution was also adopted, viz.:

> "Upon motion duly made, seconded and carried, the vice president and secretary was authorized to use the title of Executive Vice President, which authorization in no way alters the authority of the office of vice president and secretary, in accordance with the provisions of the By-Laws." (R. 187.)

On March 8, 1940, an executive committee meeting was held to authorize the sale of one-half of the shares owned by the Holding Company in Pacific Service (laundry company) to Joseph I. McInerney in settlement of the indebtedness of $15,000 owing by the Holding Company to him. (R. 188.) Thus the Holding Company became a minority stockholder in Pacific Service. (R. 189.)

At this meeting there was also ratified the sale of 280 shares of Pacific National Bank of San Francisco made by Empire Corp. to H. R. Gaither for $125 a share, and the "borrowing" by the Holding Company from Empire Corp. of the proceeds of the sale. (R. 190.) Defendant Maffei, on examination,

said the sale was caused to be made "to help Merchants Ice and Cold Storage Company." (R. 190.)

In the meantime defendant Arnold had managed to have himself elected during the year 1939 president of Merchants Ice (at a salary of $600 a month, R. 227) and M. Maffei vice president. Mr. Bercut became a director of Merchants Ice at the same time. (R. 194.) Thereupon the "looting" of Merchants Ice began. The balance sheet of the Holding Company of December 31, 1939 (Pl. Ex. 15, R. 210) shows that on that date Merchants Ice was indebted to the Holding Company in the sum of $13,636 for money advanced. (R. 198.) By the end of 1940 the Holding Company "owed" Merchants Ice $32,899.24. (R. 519.) How was such skullduggery accomplished? The answer is supplied by witness Walter O. Plagemann, secretary of Merchants Ice. He testified, on direct examination (R. 520) as follows:

> "Q. Whenever those individuals wanted any money they would go down to the Merchants Ice and Cold Storage Company and help themselves and shift the books around and charge it to this, that or the other?
>
> A. Yes.
>
> Q. That is the way they ran the Merchants Ice and Cold Storage Company?
>
> A. Yes."

There is no proof or evidence that the Holding Company ever actually received any of the money

reported to have been ostensibly "borrowed" by it from Merchants Ice. The testimony given by witness Walter O. Plagemann, Secretary of Merchants Ice, on direct examination (R. 516-517) *would seem to indicate that the defendant Arnold, as president of Merchants Ice, had a habit of helping himself to the funds of the company—and then would direct to what account his "withdrawals" were to be charged.* This is corroborated by the defendant Peter Bercut, who, on direct examination, gave the following testimony (R. 350):

"Q. Did you find any indebtedness owing to the Merchants Ice and Cold Storage Company from Mr. Arnold?

A. Well, it took months to find out that there were some charges, that it was charged back to the company. That was all an accounting business.

Q. When your accountant got through, how much did you find that Mr. Arnold had drawn down from the Merchants Ice and Cold Storage Company?

A. Quite a lot of money, but I will leave that to the accountant.

Q. That was many thousands of dollars, was it not?

A. Yes.

Q. Mr. Arnold had taken that money for his personal account, hadn't he?

A. I don't know. When we found an interest charge to the Merchants, we promptly wrote a

letter to Mr. Arnold to see which Company would be charged with that amount."

In this fashion the indebtedness of the Holding Company to Merchants Ice during the year 1940 was created, and as soon as it was created it constituted a violation of the trust Indenture entitling the trustee to foreclose unless remedied. (See Audit Report of Merchants Ice by John F. Forbes & Co., dated June 4, 1940, for the year ending Dec. 31, 1939, being Pl. Ex. 38, R. 521 at R. 533.) That is why the defendant Arnold stated, at page 733 of the Record, that towards the end of 1940 he was having trouble with the trustee under the bond indenture.

The financial situation of all these companies, then under the active management and supervision of the defendants Maffei, Arnold and Peter Bercut, became so acute that they began to rob "Paul to pay Peter." By 1940 the Holding Company was more than $15,000 in arrear on its rent to Kohler & Chase and payment having been demanded, the defendant Arnold went so far as to give a note of Merchants Ice in the sum of $9500 to the Holding Company, which in turn endorsed it over to Kohler & Chase. (See testimony of Chase R. 256.) When the discounted note of Merchants Ice came due demand for payment was made on Merchants Ice—and it was then ascertained that the said discounted note of Merchants Ice was not "valid." (R. 258.) It was, in fact, a

"dead" note. (R. 237.) So, Chase, discovering he had a worthless note of Merchants Ice as security, demanded additional security. Whereupon the defendant Arnold did not hesitate to pledge to Kohler & Chase all of the shares of Pacific Empire Corporation then owned by the Holding Company. (See R. 237.) Thereafter, the rent remaining unpaid, Kohler & Chase foreclosed the pledge and acquired the controlling interest in Empire Corp. But upon examining the portfolio of Empire Corp. they found no assets in the company. (See testimony of Chase, R. 238, 259.)

How the defendants Maffei, Arnold and Peter Bercut, ran, managed and supervised all of these companies was aptly described by defendant Maffei, on cross-examination, at page 295 of Record, where the following testimony was given:

> "Q. Now, Mr. Maffei, as a matter of fact, in the handling of these various corporations,—the Pacific Empire Holdings, Inc., Pacific Empire Corporation, Merchants Ice & Cold Storage Company, and the Laundry Company, and so on,—you and Mr. Arnold took the cash that any of these corporations had on hand at any time and used it as you pleased for the use of any of the other corporations, didn't you?
>
> A. That is right."

The defendant Peter Bercut, of course, denies all responsibility for such horrible misconduct and we

quote his testimony so that the Court may have before it his reasons. At pages 327-328 of the Record, on cross-examination, he gave the following testimony:

"Q. During the latter part of 1940 the financial condition of Merchants Ice & Cold Storage Company, according to your counsel, became somewhat aggravated and acute, is that correct?

A. Mr. Arnold put through these reports, and they were so covered that it looked fairly good to the directors, and I was of the impression that it was at the time, but when I took my report to my office and had it analyzed by my accountant, he said, 'This thing is not——'

Q. Not so good?

A. Not so good.

Q. When were you first told that by your accountant?

A. Well, from the time he first saw the report, he said that.

Q. In other words, you knew for two or three years?

A. Yes.

Q. Did you ever do anything to change it?

A. I was not managing it.

Q. I asked you, did you ever do anything to change it?

A. I wish I could have done it. I helped every time I was asked.

Q. I asked you, did you ever do anything as a director of the Merchants Ice & Cold Storage Company or the Holding Company or Pacific

Empire Corporation to bring about the change in that?

A. What could a director do? I did the best I knew, but I was not very much help; I was only one of seven directors.

Q. You and Mr. Maffei and Mr. Arnold for a period of years in fact had been running and managing the affairs of the Pacific Empire Holdings and Pacific Empire Corporation.

A. No.

Q. ——and Merchants Ice & Cold Storage Company, weren't you?

A. No.

Q. How much did you have to do with it?

A. I signed in the book when they asked me every six months or so.

Q. In other words, wherever your signature appears in the minute book of the Pacific Empire Holdings as being present and approving the acts and deeds of the officers and directors you would say you were not there?

A. I am sorry to say I was not there.

Q. Would you say that you would sign the minutes as they brought them to you?

A. Yes.

Q. Did you read the minutes?

A. No.

Q. You signed without reading them?

A. I made a mistake, I admit.

Q. Did you do that all the time?

A. All the time.

Q. From the very beginning of your position in the company to the very end?

A. Practically, yes.

Q. In other words, you would approve whatever Mr. Arnold and Mr. Maffei did without ever looking into it?

A. Yes.

Q. That is how you performed your duties as director, is that right?

A. That is right. I am a very busy man."

(d) Judgment obtained by United States v. Pacific Empire Holdings, Inc.

With such an involved and hopeless financial condition facing these defendants, we come to November 20, 1940. On that day, in an action which had been initiated in 1938, in the United States District Court, Northern District of California, Southern Division, by the United States of America v. Pacific Empire Holdings, Inc. to collect approximately $30,000 in alleged unpaid taxes (R. 168) judgment was rendered in favor of the United States against the Holding Company for $11,942.80. In the balance sheet of the Holding Company of December 31, 1939, mailed to the stockholders of June 30, 1940 (Pl. Ex. 15—R. 205), no mention or provision was made for this liability. (R. 199.)

When this judgment was handed down it came as a "bombshell" to the defendants M. Maffei and L. R. Arnold. (R. 199.) And well they might be panicky—

for they had exhausted all of the assets of all of the companies under their control and management and nothing remained with which to pay this judgment, *other than the unpledged* common and preferred shares of Merchants Ice owned by the Holding Company. (R. 199.) (See also the testimony of Arnold, R. 725.)

The defendant Peter Bercut says he knew nothing of the financial involvement of the Holding Company at this time although he admits that he knew that sooner or later it would have to be "liquidated because", so he testified, "there was no income in the place". (R. 337.) Defendant Arnold testified he kept Bercut fully advised of the condition of all these companies. (R. 723.) But be that as it may, these defendants, who had, over a period of years, squandered and looted all of the assets of the companies under their supervision and were now attempting to sustain their house of cards by looting Merchants Ice (see testimony of Peter Bercut, R. 350), suddenly were faced with the imminent threat of losing their control over Merchants Ice through a levy to satisfy said judgment. So what do we observe?

(e) Negotiations for the sale of the Merchants Ice stock to Peter Bercut.

Some time in December, 1940, the defendant L. R. Arnold, in complete secrecy and without consulting any of the directors of the Holding Company or

any of its subsidiaries (R. 727) decided to approach the defendant Peter Bercut, (R. 728), a man possessed of considerable wealth (see testimony of Bercut, R. 318, and Pl. Ex. 19, R. 574), who could be expected to be able to swing some kind of a deal.

Following is a portion of the testimony with respect to the opening negotiations with Peter Bercut given by defendant L. R. Arnold on direct examination (R. 733 to 736):

> "A. In other words, we were having some serious differences and difficulties in the board meetings, and we were exchanging letters with the trustee for the Merchants' bond issue. Other conditions bringing this about were, when we consolidated—when the Merchants had consolidated its loans from the Anglo—we had previously changed our banking from the Anglo and the Bank of America under pressure to the Pacific National Bank, where we thought we would have ample credit. However, owing to the fact that the holding company also was obligated to the Pacific National the banking department later ruled that both loans were interlocking, and consequently that cut the line of credit of the Merchants just about in half. In fact, our situation so far as credit was concerned was so serious that we had to go out to finance companies and finance some of our paper.
>
> Q. All right. What did you propose to Mr. Bercut?

A. The original discussions were along the lines of the holding company selling part of its stock—probably majority of its holdings.

Q. To whom?

A. To Mr. Bercut.

Q. For what price?

A. Well, we were mainly talking about lump sums, I believe. I think we started out with $50,000, or something like that.

Q. For how many shares?

A. Well, I believe we owned at that time about—what was it? 69,000?

Q. 78,000, wasn't it? (Indicating document.)

A. 78,000—oh, wait a minute. I beg your pardon just a second. (Examining document.) Yes, 78,000 shares. That is both common and preferred.

Q. Well, how many shares did you propose to sell to Mr. Bercut?

A. Well, we proposed to sell a majority of our holdings; in other words, that we would have to step into a minority position.

Q. For what price?

A. Our first conversation was around $50,000. We ended up——

Q. Never mind. Now, I am asking you the question, what did he say to you after you proposed it to him?

A. Well, he expressed interest. He was somewhat skeptical because of our condition first, but he——

Q. Whose condition?

A. Merchants.

one man on this whole board that they thought could run this plant.

Q. Who was that man?

A. He said Peter Bercut.

Q. Who was that director that made that statement?

A. Mr. Schinneller. He was representing a certain amount of bondholders.

Q. Wasn't Mr. Morris, former president of the Bank of America, chairman of the board of directors at this time?

A. Mr. Morris was not president of the Bank of America—I think he was vice-president.

Q. Whom did he represent on the board?

A. I have not finished my answer.

Q. Whom did he represent?

A. You were asking me the question when Mr. Arnold first spoke to me and I was going to tell you.

Q. All right, proceed.

A. He said at that time, he told me, 'You know, Mr. Schinneller made the remark at the last meeting' that I should be manager of the company, or something of that kind; so I said, 'I am very sorry he said that, because it is nothing for me; I am not looking for a job, I am not looking for anything; I am satisfied to be one of the directors. Then he said, 'We want to sell our stock, the majority stock or controlling stock', and I said, 'Well, I don't know if I am interested or not'. Well, he told me that he himself never made a success of it for fifteen years, and they could not make a success, and maybe

I could. And I said, 'What is your figure? What do you expect for it?'. And he said, '$50,000'. And then negotiations stopped there, and I said, 'I will let you know'. Then he called me again, and I went there, and he said, 'Will you make an offer?'. And I made an offer of $35,000, and I went away again. And he called me again, and then I came up and the third time that I came there was news that there was fraud in the butter or something of that kind; it was already in the estate, you know, and I heard about it, and I said, 'This looks like a bad mix-up; I am going to stay out of it'. And then he said he tried to settle the case himself so as to get me interested again, so he went down to the Bank of America and he offered to settle for $38,000 if they gave him a long time to pay, a couple of thousand a month, in order to satisfy me. But anyway, I was not interested any more, so I went away for a whole month; I went to Los Angeles and I stayed there a whole month; and then I came back and made inquiry about how much the loss would be, and he told me it would be between $30,000 and $40,000, and I finally made an offer, and he took me down to the bank and gave me the stock and made the bill of sale and everything, and I thought that was all right, so I said, 'Now you have all these matters settled between yourself and Mr. Maffei, and I want to see Mr. Maffei and tell him', and he said he had a perfect right, and they were willing and they would go all through the negotiations that would be necessary.

Q. Did you see Mr. Maffei?

A. Yes.

Q. When Mr. Arnold first approached you he asked you for $50,000?

A. Yes.

Q. For all of the stock or half the stock?

A. No, he told me all of the stock.

Q. 50,000 for all of the stock?

A. Yes.

Q. Are you sure?

A. Yes.

Q. Did he offer to sell you half of the stock for $50,000?

A. No.

Q. Why weren't you willing to accept the suggestion that you become president of the Merchants Ice & Cold Storage Company?

A. My experience in business tells me unless you have control and you can't handle it without too much interference from people that have no experience, you cannot have success.

Q. When it was suggested that you become president, you would not be interested unless you had control of the Merchants Ice & Cold Storage Company; is that right?

A. Yes.

Q. When Mr. Arnold approached you to buy this control, you say he offered to sell to you for $50,000 and you made him an offer?

A. Yes.

Q. How much did you offer?

A. $35,000, I never changed.

Q. You, of course, felt when you were offering $35,000 that you could not offer any more for that stock and make a good deal for Peter Bercut even at that?

A. In business dealings that I do I try to get the best price. Everybody advised me against it—my brother, my wife, my friends, even my attorney told me, 'Stay away from this; you are looking for trouble; it is a bad mix-up'.

Q. *When you were negotiating with Mr. Arnold you were only interested in getting this block of stock at the least possible price that Mr. Bercut could get it for; is that right?*

A. *That is the way I do business.''*

Defendant M. Maffei testified as follows (R. 224-225):

''Q. Now, Mr. Maffei, this 65,683 shares of common stock and 12,495 shares of preferred stock, in the aggregate, were all of the shares owned by Pacific Empire Holdings, Inc., or any of its subsidiaries in Merchants Ice & Cold Storage Company?

A. Right.

Q. Who conducted this transaction with Mr. Bercut?

A. Mr. Arnold.

Q. What did you have to do with it?

A. Mr. Arnold was going to contact him and make a deal.

Q. Did you conduct negotiations with Mr. Bercut?

A. I talked to Mr. Bercut once in the office about three minutes, and that was all.

Q. At that time was Mr. Bercut a director and vice-president of Pacific Empire Holdings, Inc.?

A. Yes.

Q. Was he a director of Pacific Empire Corporation?

A. To my best knowledge he was.

Q. Was he a director of Merchants Ice & Cold Storage Company?

A. Yes.

Q. Was he a director of the Pacific National Bank?

A. That is right."

(f) The transaction with Peter Bercut of January 8, 1941.

On January 8, 1941, a purported agreement, in the form of a letter addressed by Pacific Empire Holdings, Inc. to Peter Bercut, was signed in the name of Pacific Empire Holdings, Inc., by M. Maffei and L. R. Arnold with the seal thereto affixed. (Pl. Ex. 22, R. 223.) It appears that said letter agreement, though signed in the name of the Holding Company, was never *actually signed* or executed by defendant Peter Bercut. (See P. Ex. 22, R. 222 and testimony of Peter Bercut at R. 348.) However, pursuant to said agreement there was delivered by defendants Maffei and Arnold, ostensibly acting in the name of the Holding Company as president and secretary thereof, to Peter Bercut all of the shares of Merchants Ice then owned

by the Holding Company consisting of 12,445 shares of preferred and 65,863 shares of common, for the aggregate sum of $35,000, of which $25,000 was immediately paid to Merchants Ice; about $6000 to Pacific National Bank of San Francisco to apply on account of various obligations and $4000 was received by the Holding Company. (Testimony of L. R. Arnold, R. 739; and testimony of M. Maffei, R. 225.) Upon the completion of this transaction the Holding Company and its subsidiary, Empire Corp. were devoid of all assets of any substance (testimony of Arnold, R. 725; testimony of Maffei, R. 225) and were left with liabilities of over $300,000, *including an unsatisfied judgment due to the United States,* (Testimony of M. Maffei, R. 225), *and notes payable to L. R. Arnold as liquidating agent of City National Bank of San Francisco in excess of $70,000.* (R. 743.)

Of the shares delivered to defendant Peter Bercut 49,944⅓ shares of common and 3,990 shares of preferred had been pledged to Pacific Empire Corporation pursuant to the pledge agreement entered into between the Holding Company and Pacific Empire Corporation on May 15, 1935. (Pl. Ex. 10 and 11; R. 123-128.) Said pledge had never been satisfied or released. (R. 741.) On January 8, 1941, the Holding Company was indebted to Pacific Empire Corporation in a sum exceeding $150,000. (Testimony of Arnold, R. 743.) Defendant Arnold says they all knew of this pledge agreement to Pacific Empire Corporation. (R.

740.) In fact the minutes of the directors meeting of the Holding Company, held May 8, 1935, and of Pacific Empire Corporation held on May 15, 1935, which meetings were held to authorize the borrowing by the Holding Company from Pacific Empire Corporation, and the pledging as security the said shares of Merchants Ice, show that they were approved in writing by these three defendants—Maffei, Arnold and Bercut. (See testimony of Arnold, R. 705 to 709.) *Nevertheless, the rights of Pacific Empire Corporation were completely forgotten in the transaction with Peter Bercut and the only assets to which Pacific Empire Corporation could look for repayment of the money "taken" from its treasury by the Holding Company, were removed from its portfolio without it even being asked or even receiving a cent of consideration.* (See testimony of Arnold, R. 740 and 741.)

Thus were approximately 10,000 stockholders of the Holding Company, and approximately 500 stockholders of Pacific Empire Corporation, and the stockholders of City National Bank in course of liquidation, and the creditors of these companies, including the United States of America, defrauded of their property.

(g) Unfairness of the transaction to Holding Company and inadequacy of the consideration.

The evidence, as disclosed by the transcript of record, with respect to the financial condition of Merchants Ice on or about January 8, 1941, and the rea-

sonable value of the block of shares delivered on that day to defendant Peter Bercut by the defendants Maffei and Arnold, is substantially as follows:

The books and operations of Merchants Ice for the years 1936, 1937 and 1938 were audited by Haskins & Sells, C. P. A. Witness A. W. Haynes, a partner of the firm, testified from his working papers that as of December 31, 1938, the net worth of Merchants Ice was $1,270,914.70 (R. 405) or $18.17 per preferred share outstanding and $4.80 per share of common outstanding (R. 407) after giving effect to all liabilities, obligations and other deductions including an aggregate reserve for depreciation of $1,185,957.71. (R. 408.)

On cross-examination, defendant Arnold testified that a fair value for the preferred shares of Merchants Ice, in 1938, was $10 a share. (R. 879.)

The books and operations of Merchants Ice, for the year ending December 31, 1939, were audited by John F. Forbes & Co. C. P. A. Said audit is Plaintiff's Exhibit 38 set forth at pages 521-570 of the record. The balance sheet is to be found at pages 540-543 of the record. The total assets are there reported to be $2,112,978.50 and total secured and unsecured liabilities at $859,827.06, leaving a net worth of $1,253,-151.44.

The balance sheet of the Holding Company for the year ending December 31, 1939, accompanying the letter mailed to its stockholders on June 30, 1940

(See Part II of the Appendix hereof) shows total assets of a book value of $898,622.05, of which $123,456.66 represented the carry value of 12,495 shares of preferred, and $545,906.81 the carry value of 65,863 shares of common of Merchants Ice and Cold Storage Company. *The valuation placed on these shares was based upon the value stated by the audited balance sheet of Merchants Ice and Cold Storage Company as of December 31, 1939,* as prepared and certified to by Messrs. John F. Forbes and Company, C. P. A., excepting 13,000 shares of stock which were carried at $2.50 a share. (See note B to balance sheet of the Holding Company (R. 212.) Also testimony of Arnold (R. 717); testimony of Maffei (R. 202); and testimony of W. W. Haynes. (R. 405, 406).)

Defendant Maffei, on direct examination was asked whether in his opinion these values represented a fair and reasonable value of the shares of Merchants Ice then owned by the Holding Company and he replied they were. (R. 202.) Defendant Arnold, on direct examination, testified he believed the reasonable value of this block of shares on January 8, 1941 "free from pressure", to be the value at which they were carried on the books of the Holding Company. (R. 882.)

Defendant Arnold (president of Merchants Ice and Cold Storage Company) testified that "1939 was the best year Merchants Ice had enjoyed and that 1940 wasn't quite as high, but it was good", and in 1941 "the general condition (of Merchants Ice) was better". (R. 881.)

Defendant Maffei was asked, on direct examination, why he continued to add to the portfolio of the Holding Company stock of Merchants Ice when it already owned approximately 60% of the outstanding common and 33⅓% of the outstanding preferred, and he replied, "Because I thought it was worth it." (R. 204.)

Witness, Will F. Morrish, president of Bank of America from 1931 to 1934, formerly president of First National Bank of Berkeley, and at the time president of American Toll Bridge Company, was chairman of the board of directors of Merchants Ice from 1938 to about February 15, 1941. He was appointed to that office by Crocker First National Bank of San Francisco, trustee under the bond indenture, for the purpose of protecting the rights of the bondholders of Merchants Ice. (R. 452.) He was a wholly disinterested witness. He owned no stock in any of the companies involved. During his term of office he observed and watched closely the activities and progress of Merchants Ice. He kept a running record of its activities. (R. 453.) He testified that during the period he was on the board the condition of the company showed steady improvement. (R. 457.) In 1940 he was asked by defendant Arnold to make a loan of $3000 to the Holding Company, which he did, secured by 1500 shares of common of Merchants Ice. (R. 458.) In answer to a question he stated he considered the collateral to be ample security for the loan. (R. 458.)

At pages 458-461 of the Record he gave the following testimony, bearing on the value, as of January 8,

1941, of the shares owned by the Holding Company in Merchants Ice, viz.:

Q. Will you please state, Mr. Morrish, from the records that you have kept in your own handwriting, as I have observed, and from the financial reports of the company which you have examined, and from your own knowledge of the condition of this company what in your opinion was the reasonable, fair net worth of this company at the end of the year 1940, after making full allowance for all of its obligations and liabilities?

A. Well, I would have to refer to some figures that I have here.

Q. Will you please state to what you are referring?

A. As I stated, I have kept a running account of the comparison of the assets and liabilities of the company, and figured that the company in 1940 was making progress and that we were just on the verge of going into a period of very good times when it was sold. The figures that I have got down here were what I called distress figures, and figures that I believe the company could have liquidated for.

Q. By the company you mean the Merchants Ice & Cold Storage Company.

A. The Merchants Ice & Cold Storage Company, yes. The assets as I wrote them down were $1,576,000.

Q. At what time?

A. I reduced the land values down to $700,000 as compared with the book value of $865,000. I am just giving the regular figures, not the odd figures. The buildings I reduced from $1,003,000

down to $750,000, and the real estate—there was a small item of other real estate that I put in at $20,000. The cash, of course, was the accounts receivable, the same, because they had already set up a reserve for loss, and the bottles that they had for sale, which were later sold at $7,500, giving me a total of $1,576,000. That is a reduction in the assets as shown by the books of over $400,000—between $400,000 and $450,000.

Now, on the liabilities side, I figured the bonds had to be paid in full at $659,500. There was an indebtedness to Pacific Empire of $9,500, which I included, and mortgage on other real estate of $12,000; notes payable $3,200; accounts payable $160,000, and a reserve for contingencies, $15,000, or a total of $859,000. Now, that left a net value or a knockdown value, as I expressed it, of $716,000. I considered the preferred stock was probably worth its book value.

Q. That is $10 a share?

A. $10 a share.

Q. Par value, you mean by saying 'book value'?

A. The par value, not the book value. That left in the neighborhood of $300,000 value for the common stock.

Q. How many shares of common stock were there outstanding?

A. 65,000 odd shares.

Q. How many shares of Merchants Ice & Cold Storage were outstanding?

A. 107,000.

Q. 107,000?

A. Yes.

Q. How much per share of common stock would you say there was reasonably behind the outstanding common as of December 31, 1940, upon the basis of your analysis?

A. Well, basing the preferred at book, it left around $2.80 a share value for the common.

Q. For the common?

A. Yes.

Q. Now, Mr. Morrish, from your own knowledge of the condition and history of this company and the nature of its property and its maintenance of property and its business problems, would you say or have you formed any opinion with respect to whether or not the sale by Pacific Empire Holdings to Mr. Peter Bercut on or about January 8, 1941, of a block of stock in this company—Merchants Ice & Cold Storage Company, consisting of a little over 65,000 shares of common out of 107,000 and a little over 12,000 shares of preferred out of approximately 41,000 shares outstanding for the sum of $35,000 was a fair sale?

A. No, I think not.

Q. Have you formed any opinion as to what in your opinion was the reasonable value of that block of stock of 65,000 shares of common and 12,000 shares of preferred owned by Pacific Empire Holdings on or about January 8, 1941?

A. Well, I certainly think they should have been worth about $200,000 to $250,000, somewhere around there.

Q. At that time?

A. Yes."

The method followed by witness Morrish in arriving at his valuation is found in Defendant's Exhibits "E" (R. 471) and "F" (R. 474.)

On February 15, 1941 Peter Bercut became president of Merchants Ice and on February 19, 1942 he caused to be mailed to the stockholders of Merchants Ice a letter (Pl. Ex. 19, R. 574) in which he tells them *all about himself and his brother and describes how prominent in business they are and concludes with the statement:*

> "With the cooperation of your board of directors, the personnel of your organization, your preferred creditors the bondholders and the good will of your many valued customers, he expressed profound confidence and utmost faith that the financial statements of your company will show a marked improvement in a comparatively short period of time."

Accompanying said letter was the balance sheet of the company as of December 31, 1940 (found at pages 368 to 370 of Record). The net worth of the company as of December 31, 1940, after giving effect to an aggregate depreciation of $1,336,625.18 on its plant and equipment, is there reported to be $1,199,136.50, allocable to 41,615 shares of preferred ($10 par) and 107,188 shares of common ($10 par) outstanding.

So correct was the defendant Peter Bercut in his prophecy to the stockholders of Merchants Ice that immediately after he became president of Merchants

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Ice (February 15, 1941) the company began to show great improvement, as Peter Bercut "expected it would". (R. 345.) The company's condition in fact improved so much and so fast that during the direct examination of Peter Bercut (barely two years after his acquisition of the said shares) he was asked whether he would take a "*million dollars* for the same block of shares" and he replied, "No, I am not selling it today". (R. 344.)

(h) Stealth and secrecy of transaction; lack of corporate action.

The defendants Arnold and Maffei readily admit, and the corporate records in evidence conclusively show, that at no time, either before or after the transaction, were there ever held any meeting of either the board of directors or executive committee of the Holding Company or of Pacific Empire Corporation for the purpose of passing upon or authorizing or ratifying the "sale" made by the defendant Maffei and Arnold, purporting to act as president and secretary, respectively, of the Holding Company, to the defendant Peter Bercut. (See testimony of Arnold, R. 727 and 761; testimony of Maffei, R. 226.) None of the other directors of said corporations were ever consulted. (Testimony of Maffei, R. 227.) The said transaction was kept secret from the stockholders of both corporations. (Testimony of Arnold, R. 727-728; testimony of Maffei, R. 226.) Director Webb Richards, a witness called by the defendants, testified, at page 638 of the record, that the first time he knew

the true details of the transaction was not until on or about August 20, 1942, at which time Mr. Scampini disclosed to him the true facts.

The creditors of the Holding Company, who made inquiries concerning the deal, were *falsely* informed of the nature of the deal by the defendants Arnold and Maffei. (See testimony of George Q. Chase, R. 246.) Defendant Arnold admits having falsified the true nature of the "deal" to some of the directors and to Mr. Scampini, one of the creditors, who made inquiries (see R. 891-892), and witness Will F. Morrish, on direct examination, testified that "on or about February 15, 1941 (just before the annual meeting of the stockholders of Merchants Ice) defendant Arnold *told him that he was going to sell one-half of the shares of Merchants Ice owned by the Holding Company to Peter Bercut for $45,000"* and thereupon witness Morrish told Arnold that *"it was a steal at that price"*. (R. 463.)

No efforts were made by the defendants Maffei (R. 231), Arnold or Peter Bercut to obtain a better price for the block of shares "sold" to Peter Bercut although defendants Arnold and Maffei admit that they had often been told by George Q. Chase, A. J. Scampini and Joseph I. McInerney, all of them large creditors of the Holding Company, that they would be interested in buying said block of shares or portions of them should it ever become necessary for the Holding Company to dispose of them. (See

testimony of Arnold, R. 876, 888 to 891; testimony of Maffei, R. 228; and testimony of George Q. Chase, R. 240-241.) Defendant Peter Bercut admits having negotiated for the acquisition of said shares at the cheapest possible price to himself (R. 341) and defendant Arnold admits that he was "in a hurry to close the deal" and that Peter Bercut knew he was in "a hurry". (R. 875.) In fact, witness Chase, at page 246 of the Record, testified that Arnold told him the reason he made the deal with Peter Bercut was because "they were in a jam, and on the spot, and they had to do something quickly".

Defendant Arnold excuses the transaction on the ground that the financial condition of the Holding Company and of Merchants Ice required that it be done hastily and secretly because of what he termed "pressure from all sources". (R. 753.) Upon inquiry he stated that the pressure was coming from the Pacific National Bank of San Francisco, to which bank the Holding Company, Pacific Empire Corporation, and Merchants Ice owed considerable sums of money, and which loans, Arnold states (R. 733) were being criticized by the bank examiners. But H. R. Gaither, president of the bank, upon direct examination, testified that the loans of these companies were in good standing and that no pressure was exerted by the bank and that he considered the loans of these companies well secured and good. (R. 504-504.)

It is obvious that the only "pressure" under which defendants Arnold and Maffei were laboring was the

pressure of the judgment obtained by the United States against the Holding Company on November 11, 1940, upon which judgment an execution on the shares of Merchants Ice then owned by the Holding Company was anticipated, thus terminating the control which these parties exercised and had over the entire picture and exposing them to just punishment for their mismanagement.

(i) The resignation of defendant Peter Bercut as vice president and director of the Holding Company.

The trial Court in its finding III (R. 943) found that the defendant Peter Bercut became a director of the Holding Company on February 15, 1933, a member of its executive committee on February 19, 1935, and a vice-president on March 28, 1933, and continued as such until "his resignation as such director, officer and member on or about the first day of May, 1940". In finding V the trial Court (R. 946) found that on said day the by-laws provided for seven directors, but that only *six* were serving, to-wit: Maffei, Heer, Arnold, Giacchino, Richards and Ryerson. It also found that said by-laws provided for an executive committee of three directors, but that only two were serving as such, to-wit: Maffei and Arnold.

The evidence in the record with respect to these facts is as follows:

Defendant Peter Bercut, at pages 320-321 of the record, testified that around April of 1940, he *verbally*

told defendant Arnold that "I did not care to take any more interest in the company" and that he meant both the Holding Company and Empire Corp., because, he says: "I never knew the difference between the two corporations, because they were so mixed. I meant both".

At pages 321-322 of the record defendant Peter Bercut gave the following testimony:

"Q. I asked you to whom else besides Mr. Arnold in these companies, that is, the Pacific Empire Holdings and the Pacific Empire Corporation, you made known your intention not to continue as an officer or director.

A. I told Arnold.

Q. You just told Arnold and nobody else?

A. That is all.

Q. You did not tell anybody else, did you?

A. No.

Q. You never sent in a resignation to either one of the companies later on, did you?

A. Later on I asked for my resignation in writing.

Q. You asked for your resignation first?

A. Yes, and I asked later to give it to me in writing.

A. Let us get to the bottom of this thing. Did you ever file a written resignation as an officer or director of the Pacific Corporation?

A. Yes.

Q. When did you?

A. When we started to deal on this, I told Mr. Arnold that I would like to have my resignation in writing.

Q. You mean that you told Mr. Arnold you would like to submit your resignation in writing?

A. No; I wanted to resign, but I wanted everything in writing.

Q. You wanted to file it in writing?

A. I wanted to go on record.

Q. When did you tell that to Mr. Arnold?

A. Just when we were dealing for the purchase of the Merchants Ice & Cold Storage Company."

At pages 330 and 331 of the record he admits he never told defendant Maffei (who was the president of both companies) or any other director of either company that he had "orally" resigned.

He admits, however, that he continued thereafter as a director of Merchants Ice and Pacific National Bank of San Francisco.

At page 324 of the record defendant Peter Bercut testified that *after the commencement of the negotiations with Arnold, but before their completion,* and "when I saw there was a possibility of making the deal I wanted to make sure I was not a director, because I had resigned orally, and I wanted to be sure it was in writing". So he says he *signed one letter of resignation,* which is Plaintiff's Exhibit 26 (R. 400), addressed to Pacific Empire Holdings, Inc., *and antedated to March 31, 1940.*

At page 322 of the record he testified that the signature appearing at the bottom of the letter was

his—but that defendant Arnold dictated the letter to his stenographer. He then says "I never dictated anything to any of Arnold's stenographers".

It should be observed here that at the bottom of the letter of resignation appears the initials PB/LK —which—as hereinafter discussed, obviously meant "Peter Bercut to Leona Keener".

Turning to the testimony of Leona Keener (R. 675-681) we find that she, a stenographer-secretary in the office of the Holding Company during January, 1941, on direct examination testified as follows (R. 678-681):

"Q. Were you acting as such stenographer-secretary on or about January 8, 1941?

A. Yes.

Q. And as such do you recall anything unusual happening, or any dictation which took place at or about that time, or immediately prior or immediately thereafter, concerning the resignation of Mr. Peter Bercut?

A. Yes.

Q. And do you recall that incident?

A. I do recall it.

Q. Approximately when did it take place?

A. It was approximately in January—the latter part of January.

Q. Of what year?

A. Of 1941.

Q. And what did take place? Tell us to the best of your recollection exactly what happened.

A. Mr. Bercut was in the office and asked me to dictate—or to dictate to me a resignation to the

holding company as officer and director of that company.

Q. And did you take it in your notebook then at that time?

A. Yes.

Q. And have you got that notebook with you?

A. Yes, I have. (Producing notebook.)

Q. Will you please find it—look at your notebook and see if you have any record of the dictations of Mr. Peter Bercut?

A. I have it.

Q. And what is that notebook which you have in your hand now?

A. This is the notebook that I used for the holding company. This is from the year '41 I'm looking at right now.

Q. And what page are you looking at?

A. I don't quite understand you.

Q. I say what page of the notebook? Have you got the pages numbered?

A. No, I haven't.

Q. Well, do you find any record in that notebook which you have of the dictation of Mr. Peter Bercut to you concerning his resignation?

A. Yes.

Q. And is it written in shorthand?

A. Yes, it is.

Q. And will you read it into the record, please?

A. Yes. (Reading from notebook.) By Peter Bercut to Pacific Empire Holdings. 'Because of the pressure of this business I will be unable to devote sufficient time to the company to be of real value. Consequently please consider this

letter as my resignation as an officer and director of Pacific Empire Holdings, Incorporated.'

Q. Have you got any notation on that page of the date on which the dictation was given to you?

A. The date was January 29th, '41.

Q. And who were present, so far as you recall, at the time the dictation took place?

A. Mr. Bercut and Mr. Arnold and myself.

Q. Was there any discussion between these parties in your presence, that you recollect?

A. Yes, there was. The resignation was dated back to, as my records show, March 3rd, 1940.

Q. And was anything said concerning that phase of the transaction or dictation, by any of the persons present?

A. Nothing, except to date it back.

Q. And who said to date it back, if you recall.

A. I couldn't say who said it.

Q. Did you date it back pursuant to instructions?

A. Yes, I did.

Q. And you afterwards transcribed the notes which you have just read into letter form, did you?

A. Yes.

Q. And what did you do with that letter?

A. Mr. Bercut signed it. I gave it to Mr. Bercut, and he signed it.

Q. And then what happened to the letter?

A. And then, as I recall, he turned it over to Mr. Arnold. I couldn't be definite on that.

Q. I see. Was any dictation given to you by Mr. Peter Bercut at that time or at any other time to your knowledge concerning resignation in the Pacific Empire Corporation?

A. Nothing at all; that is the only one I have."

On cross-examination Miss Keener produced the shorthand notebook wherein she took down in shorthand the dictated letter of resignation—and a photographic copy of the page upon which said letter appears is to be found at page 690 of the record.

The defendant Arnold testified flatly that on January 8, 1941, the defendant Peter Bercut was vice-president, a director and member of the executive committee of the Holding Company, and a director and vice-president of Empire Corporation, a director of Merchants Ice and Cold Storage Company and of Pacific National Bank of San Francisco. (R. 719-721, 724, 732-767.)

At page 745 of the record defendant Arnold testified that he received the letter of resignation of Peter Bercut (P. Ex. 26) "on or about the time of the conclusion of the negotiations having to do with the sale". At page 746 he testified that the question of whether Peter Bercut should resign as a director (in view of the deal) was brought up for discussion by defendant Peter Bercut—*and that the letter of resignation was dictated by Peter Bercut* in the offices of the Holding Company "on or about the time when we were concluding the negotiations, yes".

Defendant Maffei flatly testified that Peter Bercut was a director, vice-president and member of the executive committee and director and vice-president of Empire Corporation on January 8, 1941, and a director of Merchants Ice and Pacific National Bank of San Francisco. (R. 224-225.) At page 262 of the record, Maffei testified that about a week or two after the "deal was made" Mr. Arnold advised him that Peter Bercut had resigned from the corporation "and that he had the girl in the office date back the resignation two or three weeks". (R. 263.)

It should here be again observed that as shown by the minute books of the Holding Company (Vol. 5, pages 100-101) a special meeting of the executive committee of the Holding Company was held on October 17, 1940. On the same day a special directors meeting of Empire Corporation was held. At both meetings Peter Bercut is declared in the minutes to have attended (R. 192-193), and defendant Maffei testified the minutes were correct (R. 194), although defendant Bercut denies having attended either meeting and the minutes were not signed by him.

It is evident that the only particle of evidence in the record sustaining the finding of the trial Court to the effect that Peter Bercut had resigned as an officer and director of the Holding Company and Empire Corporation is the declaration by Peter Bercut to the effect that on or about May 1, 1940, he "verbally" told defendant Arnold, who, like Bercut,

was a mere vice-president and director, and *no one else* that he, Bercut, did not want to have anything more to do with the companies.

Without considering here the legal insignificance of such a statement made by one director of a company to another director, insofar as it bears on the question of whether one is or is not a director of a corporation, we should point out to the Court that defendant Peter Bercut did not hesitate, *on two occasions to testify falsely on the stand.*

First, he testified that he never dictated the said letter of resignation dated March 31, 1940, whereas, a wholly disinterested witness, Leona Keener, a mere stenographer, proved conclusively by her notebook that Bercut did dictate said letter to her on January 29, 1941, *and did date it back to March 31, 1940.*

Secondly, the defendant Peter Bercut was also asked (R. 359) whether he then owned 500 shares of Frostcraft Corporation. He there testified that he did not—and that he did not "remember" whether Merchants Ice owned the 500 shares when he was president. Witness C. J. Collins, president of Frostcraft was called as a witness on behalf of plaintiff and at page 441 of the record testified that Mr. Plagemann (secretary of Merchants Ice) caused to be transferred 500 shares of Frostcraft (certificate in name of A. N. C. Produce Co.) to Peter Bercut and Henri Bercut, each receiving 250 shares.

The weakness of defendant Peter Bercut's assertion that he verbally resigned in May of 1940 is best emphasized by his failure to also resign from Merchants Ice which, throughout the intervening months to January 8, 1941, continued to be controlled by the Holding Company and looted by Maffei and Arnold, and the same motives which prompted his alleged oral resignation from the Holding Company should have prompted him likewise to resign from Merchants Ice.

(j) The insolvency of the Holding Company. Appointment of receiver and repudiation of transaction.

As the result of the said transaction the Holding Company found itself without assets. It had previously pledged to Kohler & Chase all of its shares in Pacific Empire Corporation as security for the payment of about $13,000 due to Kohler & Chase for unpaid rent. Not being able to pay said rent, after the sale of Merchants Ice stock, Kohler & Chase foreclosed on the pledge and acquired ownership of all of the stock of Pacific Empire Corporation owned by the Holding Company. (See testimony of George Q. Chase, R. 237.)

Prior to the transaction with Peter Bercut, the Holding Company had already sold 47½% interest in California Pacific Service, Inc. to Joseph I. McInerney for $15,000. (R. 188.) The 47½% remaining in the Holding Company had been pledged by the Holding Company to Messrs. Ellis & Steindorf, and

Conrad T. Hubner, as security for the payment of several thousand dollars owed to these attorneys for legal services performed by them. (See testimony of Arnold, R. 884.)

The stock of Pacific National Bank of San Francisco owned by Pacific Empire Corporation had been sold to Mr. Gaither and the proceeds applied on account of the loans of the Holding Company to Pacific National Bank of San Francisco. (See testimony of Maffei, R. 190, and testimony of Gaither, R. 504.) The remaining assets of the Holding Company were of no value. (See testimony of Arnold, R. 884.)

The aggregate liabilities of the Holding Company exceeded $300,000, of which over $150,000 was owing to Pacific Empire Corporation; over $30,000 to California Pacific Service, Inc., approximately $12,000 to the United States on said judgment; $13,000 to Kohler & Chase for unpaid rent; the franchise taxes remained unpaid; Corporation Trust Company remained unpaid, and in addition there were other creditors. (See testimony of Arnold, R. 842, for a list of creditors.

On or about July 20, 1942, the Holding Company received a letter from Thos. H. Wingate, an attorney in Wilmington, Delaware, (claiming to represent certain stockholders) demanding information concerning the affairs of the company and threatening suit to appoint a receiver. (Defendants' Exhibit D, R. 424.) Thereupon defendants Arnold and Maffei con-

sulted with A. J. Scampini, Esq., who, up to 1936, when he resigned (R. 153), had been the attorney for the Holding Company and Pacific Empire Company, as well as an officer and a director of Pacific Empire Corporation and of Merchants Ice & Cold Storage Company.

Defendants M. Maffei and L. R. Arnold, at said conference with A. J. Scampini, divulged the true situation of the Holding Company and of Pacific Empire Corporation, and all of the facts and circumstances surrounding the transaction of January 8, 1941, with Peter Bercut. (R. 821.) Mr. Scampini thereupon advised said parties that in his opinion, the Holding Company was insolvent; that the said transaction was illegal and that they should consent to the appointment of a receiver for the purpose of prosecuting an action on behalf of the Holding Company, its creditors and stockholders, looking towards recovering the shares of Merchants Ice which had been illegally delivered to Peter Bercut on January 8, 1941. (See testimony of Arnold, R. 820; testimony of Richards, R. 642.)

Thereupon, a special meeting of the Board of Directors of Pacific Empire Holdings, Inc. was held on August 20, 1942, by written consent. At said meeting, *which was the first meeting held since prior to October 27, 1940, the written resignation of Peter Bercut, dated March 31, 1940, (but signed and delivered by him on or about January 29, 1941) was submitted to*

the board and accepted. At said meeting the whole transaction of January 8, 1941, with Peter Bercut, was for the first time divulged to the directors and said directors thereupon passed a resolution consenting to the appointment of a receiver in equity for the company so that said receiver might prosecute proper action against Peter Bercut and all other persons involved (including defendants M. Maffei and L. R. Arnold), looking toward the recovery of the shares of Merchants Ice delivered to Peter Bercut. (See testimony of director Webb Richards, R. 642.)

On August 31, 1942, in a proceeding for that purpose, Thos. H. Wingate, plaintiff herein, was appointed receiver in equity of Pacific Empire Holdings, Inc. On September 9, 1942, said receiver, acting through his attorney, formally repudiated and rescinded the said transaction of January 8, 1941. (Pl. Ex. 34, R. 393.) Thereupon the complaint in this cause was filed.

Part IV.

PROCEEDINGS BEFORE THE DISTRICT COURT.

(a) Complaint.

The complaint filed by plaintiff in this cause consists of three counts.

The first count seeks a declaration by the Court to the effect that: (a) a purported letter agreement between Pacific Empire Holdings, Inc. and Peter Ber-

cut, dated January 8, 1941 (Plaintiff's Exhibit 22), was and is not a corporate act valid and binding upon Pacific Empire Holdings, Inc. or plaintiff, as its receiver; (b) that title to the 78,365 shares of Merchants Ice and Cold Storage Company stock delivered to the defendant Peter Bercut pursuant to said letter agreement is still vested in plaintiff; (c) that the defendants Peter Bercut and Henri Bercut are holding said shares as trustees for plaintiff; (d) that the defendants Peter Bercut, Henri Bercut, M. Maffei and L. R. Arnold account to plaintiff for their conduct as such trustees and pay over to plaintiff any profits secured or obtained by any of them as the proximate result of said transaction.

The second count is predicated on the proposition that plaintiff, as receiver, vested with title to all of the assets of Pacific Empire Holdings, Inc. is the lawful owner of said 78,365 shares of Merchants Ice and Cold Storage Company now in the possession of Peter Bercut and Henri Bercut; that demand for their return having been made and refused, plaintiff is entitled to bring an action for claim and delivery for said shares and for all damages suffered as the result of the failure of the defendants to deliver them to plaintiff.

The third count is predicated on the proposition that the defendants Peter Bercut, Henri Bercut, M. Maffei and L. R. Arnold converted to their own use and benefit the said 78,365 shares of Merchants Ice

and Cold Storage Company to the damage of Pacific Empire Holdings, Inc. in the sum of one million dollars.

(b) Answer of defendants Peter & Henri Bercut.

The answer of the defendants Peter Bercut and Henri Bercut, substantially alleges that Peter Bercut was not an officer or director of Pacific Empire Holdings, Inc. at the time of the transaction, and that said transaction was in every respect valid and fair and legally binding upon Pacific Empire Holdings, Inc. and its receiver. They deny that they have converted said shares and allege that they are the lawful owners of them.

In addition, said defendants have pleaded as and by way of a second, special defense the lack of capacity on the part of plaintiff to prosecute this action. Said defendants have also sought to plead, by way of a third, special defense, a failure on the part of plaintiff to properly rescind said contract; and by way of a fourth and fifth special defense they have sought to plead an estoppel against plaintiff arising out of a general claim of informal ratification by the directors and stockholders of Pacific Empire Holdings, Inc. resulting from their non-action or non-protest as well as their alleged laches.

Said defendants subsequently filed an amended answer and cross-complaint against plaintiff claiming that they have not received all of the shares agreed to

be delivered to them and they now seek a judgment of this Court for the alleged undelivered portion of the shares. They further seek a judgment against plaintiff for $3850 alleged to have been advanced by them to Pacific Empire Holdings, Inc.

(c) Answer of defendants M. Maffei and L. R. Arnold.

The answer of the defendants M. Maffei and L. R. Arnold, substantially, deny that they have any of the said shares or that they have converted any of them to their own use or that they have in any way personally profited as the result of the transaction dated January 8, 1941, with Peter Bercut.

(d) Proceedings.

The cause was tried in the District Court, before the Honorable Michael J. Roche, judge, sitting without a jury.

On July 6, 1943, the Court entered a minute order awarding judgment to the defendants and against plaintiff, each side to bear its own costs. (R. 939.)

Counsel for the defendants Peter Bercut and Henri Bercut thereupon filed their proposed findings of fact and conclusions of law, and plaintiff filed with the Court his exceptions to said proposed findings and conclusions. (R. 930-938.) Plaintiff accompanied said exceptions with his proposed findings and conclusions, and also moved the Court for a rehearing and new trial, and a motion for judgment in favor of plaintiff, specifying therein his grounds. (R. 958.)

On August 9, 1943, the Honorable Michael J. Roche, judge, denied plaintiff's motion for judgment and for a rehearing and new trial (R. 959), and signed the findings and conclusions proposed by the said defendants with one change in finding XI, wherein the trial Court struck out a finding which originally read to the effect that plaintiff had failed to tender to the defendants Peter and Henri Bercut the sum of $35,000 or any sum. As the findings now stand, the trial Court failed to find with respect to this point. (R. 953.)

Judgment was thereupon entered in favor of defendants upon said findings. (R. 956.)

On August 13, 1943, plaintiff filed his notice of appeal to this honorable Court and designated for inclusion in the record on appeal the complete record and all the proceedings and evidence in the action, including all exhibits, which by stipulation and order of Court have been sent up in their original form.

Part V.

QUESTIONS INVOLVED—HOW RAISED?

1. Are the findings of fact of the trial Court numbered III, IV, V, VII, VIII, IX, X, XII and XIII, or any of them, supported by any substantial evidence in the record?

2. Are the conclusions of law made in this cause by the trial Court supported and warranted by any proper finding of fact?

3. Was the judgment entered in the cause by the trial Court in favor of the defendants and against plaintiff consistent with the law of the case, just, and proper?

4. Should not the trial Court, on the facts and the evidence disclosed by the record, have entered judgment in favor of plaintiff and against the defendants as prayed for in plaintiff's complaint?

We submit and contend that questions 1, 2 and 3 above should be answered in the negative, and with respect to question No. 4, the trial Court should have entered judgment in favor of plaintiff as prayed for in plaintiff's complaint.

The following matters of record are relied upon by plaintiff to frame said issues:

(a) The pleadings.

(b) The evidence of the case adduced during the trial as disclosed by the record together with the exhibits.

(c) The minute entry made by the Court, rendering judgment in the cause in favor of defendants. (R. 939.)

(d) The exceptions filed by the plaintiff to the findings of fact and conclusions of law proposed in the cause by the defendants Peter Bercut and Henri Bercut. (R. 930.)

(e) The findings of fact and conclusions of law proposed by the plaintiff to the Court. (R. 904.)

(f) The findings of fact and conclusions of law made by the Court. (R. 940.)

(g) The judgment entered in the cause by the trial Court. (R. 956.)

(h) The motion made by plaintiff to the trial Court for a rehearing, new trial and for judgment in favor of plaintiff. (R. 957.)

(i) The denial of said motion by the trial Court. (R. 959.)

Part VI.

SPECIFICATIONS OF ERROR.

Point No. 1—Finding III of the trial Court is contrary to the evidence, and erroneous insofar as it purports to find that defendant Peter Bercut resigned as an officer, director and member of the executive committee of the Holding Company on or about the first day of May, 1940.

Point No. 2—Finding IV of the trial Court is materially contrary to the evidence and erroneous insofar as it purports to find that the reasonable value, on January 8, 1941, of the 12,493 shares of preferred and 65,863 shares of common of Merchants Ice "sold" to Peter Bercut was not in excess of the sum of $35,000.

Point No. 3—Finding V of the trial Court is materially contrary to the evidence and erroneous insofar

as it purports to find that on January 8, 1941, the defendant Peter Bercut was not a director and member of the Executive Committee of the Holding Company.

Point No. 4—Finding VII of the trial Court is wholly contrary to the evidence, and erroneous in fact, conclusion and law.

Point No. 5—Finding IX of the trial Court is wholly contrary to the evidence and erroneous.

Point No. 6—Finding X of the trial Court is wholly contrary to the evidence and erroneous.

Point No. 7—Findings XII and XIII of the trial Court are wholly contrary to the evidence, and erroneous in fact, conclusion and contrary to the law of the case.

Point No. 8—The conclusions of law and judgment of the trial Court are erroneous, not based upon any proper findings and contrary to the law and equity of the case on the following legal and equitable grounds:

(a) The transaction of January 8, 1941, purported to have been entered into between the Holding Company and defendant Peter Bercut was not a valid corporate act binding upon the corporation, its creditors, stockholders or receiver;

(b) The said transaction was legally void because it constituted a flagrant breach of trust on the part of fiduciaries;

(c) The said transaction was legally void because it constituted a flagrant fraud on creditors and was intended to and did succeed in hindering, delaying and defrauding the creditors of the Holding Company.

Point No. 9—Judgment in this cause should be rendered in favor of plaintiff as prayed for in plaintiff's complaint.

Part VII.

THE ARGUMENT.

POINT No. 1.

In its finding III, the trial Court found that defendant Peter Bercut resigned on or about May 1, 1940, as a director, vice president and member of the executive committee of the Holding Company.

Finding III of the trial Court is contrary to the evidence and erroneous in that the record conclusively shows the defendant Peter Bercut *did not* resign as an officer and director of the Holding Company until on or about January 29, 1941, and his resignation was never accepted until October 20, 1942.

Here, we respectfully refer the Court to Part III (i) of this brief wherein we have set forth the facts and the evidence disclosed by the record with respect to the resignation of Peter Bercut as an officer and director of the Holding Company,

and, by reference, we here incorporate the record pages and excerpts of testimony there quoted.

The claim of Peter Bercut that he "verbally" resigned on or about May 1, 1940, by so stating to the defendant Arnold, is denied by the defendants Maffei and Arnold, and by the subsequent conduct of defendant Peter Bercut.

Why should Peter Bercut tell Arnold—a mere vice president like Bercut, that he, Bercut, was resigning? Why did not Bercut tell Maffei, who was the president? Why did not defendant Bercut send in a written resignation after he told Arnold that he wanted to resign? Why did he keep his alleged "verbal" resignation a secret from every other director?

Why do the minutes of the executive committee meeting of the Holding Company, held October 27, 1940 (R. 192), and the special directors meeting of Empire Corporation, held the same day (R. 193), state that defendant Peter Bercut was present—if in fact he had already resigned?

Why did Peter Bercut dictate the letter of resignation after the consummation of the deal—and ante date it to March 31, 1940? Why did he not resign at the same time from Empire Corporation, and why did he continue to act as a director of Merchants Ice and Pacific National Bank, if in fact, as he states, he wanted to sever his relations with these concerns?

The only reasonable answer to these questions is that defendant Peter Bercut did not "verbally" resign on or about May 1, 1940. He only resigned from the Holding Company management after the consummation of the deal (as stated by defendant Maffei (R. 267) and defendant Arnold (R. 745), and ante dated his resignation back almost a year—because he suddenly realized the legal infirmity of the deal he had made and he tried, as best he could, to remedy the weakness of the transaction.

The finding of the trial Court on this point is further erroneous because, assuming, *arguendo,* that Peter Bercut verbally told Arnold, on or about May 1, 1940, that he was terminating his relations with the company, such a statement has no legal significance or effect. The by-laws, admitted in evidence, state that a resignation of a director must be first "duly accepted" by the board before there is a vacancy. (See Part I of Appendix hereto.)

In *Bowen v. Imperial Theatres Inc.,* 13 Del. Ch. 120, 115 Atl. 918, it was held that:

> "Where the minutes failed to recite that a person had been elected director but did record that he was a member of the Executive Committee (Sec. 9 of the Delaware Corporation Laws requiring members of committees to be directors) such record is evidence that the person has acted as a director."

In *Lippman v. Kehoe Stenograph Co.,* 11 Del. Ch. 190, 98 Atl. 943, it was held that when a director sends in his resignation and it is not acted upon he still continues as a director.

Also, in *Chelsea Exchange Corp.,* 18 Del. Ch. 287, 159 Atl. 432, it was held that a director's resignation must be accepted before it is effective.

To the same effect are:

Sec. 591 of 6a *Cal. Juris on Corporations;*
Boston Tunnel Company v. McKenzie, 67 Cal. 485;
Reed & Co. v. Harshall, 12 Cal. App. 697.

We respectfully submit that the record conclusively shows the defendants M. Maffei, L. R. Arnold and Peter Bercut to have been the "managing directors" of the Holding Company and all of its subsidiaries at all times until on or about January 29, 1941, and their control over the management of these concerns was assured by means of the voting trust. (Pl. Ex. 20, R. 216), with respect to the Holding Company, and the proxy (Pl. Ex. 21, R. 218) with respect to Empire Corporation.

In view of these undisputed facts, the defendants Maffei, Arnold and Bercut, on January 8, 1941, were fiduciaries of the Holding Company and its subsidiaries, their creditors and stockholders. (See *Pepper v. Litton,* 308 U. S. 295.) In *Wagner Electric Corporation v. Hydraulic Brake Co., et al.,* 257 N. W. 884 (Mich. 1934), it was held:

"When a holding company controls a corporation, elects its officers and determines its policy, the officers elected by it must act in good faith and for the benefit of the stockholders of the subsidiary corporation."

POINT No. 2.

In its finding IV the trial Court, among other facts, finds that "on January 8, 1941, the reasonable value of said shares (to-wit: 12,493 shares of preferred and 65,863 shares of common of Merchants Ice) was not in excess of the sum of $35,000".

We respectfully submit that in view of the evidence adduced at the trial (which we have summarized, by quoting the record, under Part III (g) of this brief) the finding of the trial Court with respect to the reasonable value of said block of shares of Merchants Ice, is clearly contrary to the evidence, and erroneous. All of the evidence in the record (excepting the irrelevant testimony of Peter Bercut, who admits he tried to buy the block of shares as cheaply as possible) is to the effect that the reasonable value of said block of shares (keeping in mind that it represented more than one-third of the outstanding preferred and more than one-half of the outstanding common of Merchants Ice) was, on January 8, 1941, not less than $250,000.

The only substantial testimony in the record with regard to the reasonable value of this block of Mer-

chants Ice stock was introduced by plaintiff. The defendants offered no real evidence as to the intrinsic reasonable value of this block of shares. The testimony of defendants' witnesses, Louis T. Samuels (R. 643-663) and F. C. White (R. 580-588) and L. J. Spuller Jr. (R. 589-591) is clearly worthless. But the plaintiff introduced into the record not only the appraisal of the company's properties made by the American Appraisal Company in 1927, supplemented by an engineering report made in 1936, but also audits of the company's operations and balance sheets for the years 1937, 1938 and 1939, prepared by independent certified public accountants. In addition to this evidence we have the irrefutable and uncontradicted testimony of William F. Morrish, not only a most competent and informed witness in that respect, but in addition, a most disinterested witness. To our mind the testimony of William F. Morrish is conclusive with respect to the then true, intrinsic, reasonable value of the block of Merchants Ice stock acquired by Peter Bercut. Morrish testified that, in his opinion, a knock down, very conservative liquidating value for the block on January 8, 1941, was not less than $250,000 (R. 461), to which should be added an additional value for the fact that it represented the control of a long established going concern. *We respectfully submit that the defendants, whose burden it was to prove that Peter Bercut paid an adequate price for this block of shares,* failed completely to rebut the testimony of Mr. Morrish. Furthermore, the testimony

of Mr. Morrish is amply supported by the appraisals and audits of the company offered and received in evidence.

To hold that the sum of $35,000 paid for this block of shares by Peter Bercut (out of which sum the Holding Company actually received the net sum of less than $5000 for the benefit of its general and judgment creditors) represents a "fair consideration" would be a mockery.

POINT No. 3.

Finding V of the trial Court to the effect that on January 8, 1941, the defendant Peter Bercut was not a director and member of the executive committee is clearly erroneous and contrary to the evidence for the reasons discussed herein under Point No. 1.

POINT No. 4.

Finding VII of the trial Court is wholly contrary to the evidence, and erroneous in fact, conclusion and law for the following reasons:

By said Finding VII the trial Court, among other things, found that on January 8, 1941, Pacific Empire Holdings, Inc., by and through its president M. Maffei, and its secretary L. R. Arnold, *acting within the course and scope of their authority for and on behalf*

of said corporation sold to Peter Bercut, for and on behalf of himself and Henri Bercut, 12,495 shares of preferred stock and 65,863 shares of common stock of Merchants Ice & Cold Storage Company for $35,000.

This finding of fact is erroneous and contrary to the evidence for the reason that the defendants M. Maffei and L. R. Arnold, as president and secretary, respectively, of the Holding Company, had no authority to enter into said transaction for and on behalf of the corporation and did not act within the course and scope of their authority as such officers and the said transaction was not the valid, binding corporate act of the corporation—all of which will be hereinafter further discussed under subdivision (a) of our Point No. 8.

Said Finding VII further finds, among other things, that said agreement of sale was in all respects fair and equitable to Pacific Empire Holdings, Inc. and was entered into in good faith after lengthy negotiations at arms length by and between the said corporation acting through independent and disinterested officers and directors and said Peter Bercut upon a full disclosure of all facts relating thereto at a time when the said defendant Peter Bercut was no longer a director or member of the executive committee of the corporation.

In view of the record and the testimony quoted by us under Part III (d)(e)(f)(g) and (h) of this

brief, it is almost unbelievable to us that the trial Court should have made such a finding.

The Record conclusively shows that the transaction was "hastily" entered into by the defendants Arnold, who admits that he was in a hurry because "they were on a spot and in a jam" (R. 246); that the negotiations were conducted exclusively between the defendant Arnold and Peter Bercut, while the defendant Maffei, president, was called in to sign the document (R. 224); that it was kept a complete secret from all stockholders, directors, creditors of the company; and that the nature of the transaction was in every case misrepresented to the creditors and directors. Not a single directors' meeting was held, either prior, concurrently or after the transaction; no executive committee meeting was ever held; not a stockholders' meeting was ever called, and none of the other directors, which constituted a majority of the board, were ever consulted about the transaction. (See testimony of Arnold, R. 761; and testimony of Maffei. (R. 225.)

The finding of the trial Court that defendant Peter Bercut was not, at the time, an officer and director of the corporation is a mere repetition of finding III, and the finding to the effect that the price of $35,000 for the said shares was the fair and reasonable and proper price is again a mere repetition of finding IV.

The finding of the trial Court that said agreement of sale was in all respects fair and equitable to Pacific

Empire Holdings, Inc., to our mind, is a travesty of justice because, as defendants Arnold and Maffei admit (R. 225, 884) the result of the transaction assured the collapse of the Holding Company and the defraudment of its creditors and stockholders and the creditors and stockholders of Empire Corp. as well as the United States Government. How any agreement, whereby an asset, reasonably worth not less than $250,000 at the time, and carried on the books of the corporation at over $650,000, and constituting practically 70% of the assets of the Holding Company, which is hastily and secretly transferred over to one of the company's officers and directors for a net sum of $4000, can be held to be fair and equitable is to us inconceivable. We will return to a further discussion of this phase of the case in our argument under Point No. 8.

POINT No. 5.

In its finding IX the trial Court found that the "sale" of Merchants Ice stock made by the defendants Maffei and Arnold to defendant Peter Bercut on January 8, 1941, did not render Pacific Empire Holdings, Inc. insolvent, or unable to meet its debts, and was not in fraud of its stockholders or creditors.

We respectfully submit that the evidence set forth in the Record and cited by us under Part III (j) of this brief, conclusively shows that on January 8, 1941,

the 12,493 shares of preferred and 65,863 shares of common of Merchants Ice, owned by the Holding Company, represented almost the entire asset position of the Holding Company. (See balance sheet—Pl. Ex. 15, R. 210.) At the time of the "sale" of these shares the aggregate liabilities of the Holding Company, then due and payable, exceeded $300,000. (Testimony of Arnold, R. 842; testimony of Maffei, R. 183, 225.) Upon the "sale" of said shares for a nominal consideration the Holding Company had substantially "nothing" left with which to pay any of its creditors or with which to satisfy the judgment for $11,942.80 obtained by the United States on November 20, 1940. (R. 199).

To find that such transaction did not render the Holding Company insolvent and did not constitute a fraud on creditors, it is respectfully submitted, constitutes a denial of the obvious.

> "Insolvency is an inability to fulfill one's obligations according to his undertaking, and a general inability to answer in court for all liabilities existing and capable of being enforced, and not merely an obsolute inability to pay at some future time, upon settlement of business". (*First National Bank v. Walton,* 13 Colo. 265).

The term "insolvency" denotes the insufficiency of the entire property and assets of an individual to pay his debts. (*Phipps v. Harding* (C.C.A. 7th), 70 Fed. 468, 30 L.R.A. 513.)

We shall hereafter, in this brief, under Point No. 8(c) argue the question of whether or not the said "sale" constituted a fraud on the creditors and stockholders of the Holding Company.

POINT No. 6.

In its finding X, the trial Court found that on January 8, 1941, Merchants Ice was in an insolvent condition and about to collapse financially. It is respectfully submitted that this finding is wholly contrary to the evidence. The financial condition of Merchants Ice, at or about the end of 1940, is fully discussed under Part III (g) of this brief, and the Record testimony there quoted is incorporated herein.

Throughout its long history, and including the depression period, clear down to January, 1941, Merchants Ice never defaulted in a single obligation. (See testimony of O. H. Plagemann, R. 512.) Throughout the years 1937 to 1940 it had shown gradual and progressive improvement. (See testimony of Morrish, R. 457.) In 1939 it had enjoyed its best year in many years. (See testimony of Arnold, R. 881.) On June 30, 1940, the stockholders of the Holding Company were advised, in writing, by defendants Maffei and Arnold that there were reasonable possibilities of Merchants Ice going on a dividend basis in the very near future. (See Pl. Ex. 15, R. 205, quoted verbatim under Part II of the appendix hereto.) The net worth of the cor-

poration, as shown by the balance sheet dated December 31, 1940 (Pl. Ex. 31, R. 368) was $1,199,136.50. The prospects and future of the company were increasingly bright as shown by the testimony of Will F. Morrish. (R. 486.) In view of this undisputed testimony we confess we cannot understand the finding of the trial Court that on January 8, 1941 Merchants Ice was insolvent.

The rest of finding X purports to find facts upon which could be based an argument or conclusion to the effect that the Holding Company, its creditors and receiver, are estopped from attacking the legality of the transaction of January 8, 1941. The trial Court, in this respect, ambiguously finds substantially to the effect that defendant Peter Bercut, relying upon the validity of the "purchase" made by him from the Holding Company, took over the management of Merchants Ice and thereafter loaned to it his credit, services and business ability, with the result that Merchants Ice prospered considerably and throughout this period of revival the Holding Company (then still under the control and supervision of the same defendants) acquiesced in such conduct and failed to protest or rescind the transaction. The trial Court concludes from this that plaintiff, as receiver, as well as the corporation, and its creditors, are now estopped from attacking the validity of the transaction.

The answer to this most unreasonable and erroneous finding and rule of law is to be found in the case of

Wing v. Dillingham, 239 Fed. 54, a case having some of the aspects of the case at bar. There a corporation had contracted to purchase certain lands, but because of financial difficulties it was unable to complete the payments. At a meeting of the directors in 1903, (six of whom were lawyers), at the urging of his co-directors, the defendant agreed to complete the payments, take title in his own name, and, if the corporation would repay him the sums advanced within six months, he was to convey the property to the corporation. A *resolution* reciting all of the facts was then adopted by the board and a contract entered into. Defendant performed the contract, but the corporation subsequently went into receivership. *Twenty months later* the receiver tendered to the defendant the amounts advanced by him and demanded a conveyance. The defendant contended that the corporation had only a *six months* option, which it had failed to exercise—and that the obligation to convey no longer existed.

In discussing the option contention of the defendant the Court, at page 58, said:

> "The option, running for six months, from Wing to plaintiff, may be eliminated. For illustration: Say that no option to buy was granted, would this change the status? If the Oil Company held the legal title to the land in question, and made a fee simple conveyance to the defendant, would this aid or change the transaction? Surely not. *It has never been held that a director can buy anything of value from the corporation he serves,*

unless the purchase is fairly made and to the advantage of the company.

* * * One of the most frequent frauds perpetrated upon a corporation and its stockholders is where one or more of the directors purchase property from the corporation, directly or indirectly, or participate in the profits of such purchase. The law is well settled that a director's purchase of property from the corporation is voidable at the option of the corporation, even though the director paid fully as much as the property is worth. Cook on Corporations, 653."

So holding, the Court held that a *twenty months* delay by the receiver in attacking the validity of the transaction was not *unreasonable and did not constitute laches.*

The much quoted opinion of Chancellor Wollcot, rendered in *Loft, Inc. v. Guth,* 2 Atl. (2d) 225, and of St. Sure, J., rendered in *Blum v. Fleishhacker,* 21 Fed. Supp. 527, constitute a complete refutation of the propriety of such a finding and conclusion as was made in this cause by the Court below.

See, also, the case of *Hotaling v. Hotaling,* 193 Cal. 368, at 377, for a discussion of this same principle.

In concluding our argument on this point we should observe *that in our case the defendants were in control of the defrauded corporation* until the appointment of the receiver. Should the receiver now be held estopped because *the defendants did not sue themselves?*

POINT No. 7.

Findings XII and XIII of the trial Court are wholly contrary to the evidence, erroneous in fact, conclusion and the law of the case.

The trial Court in its findings XII and XIII did not find any ultimate fact. Instead, it found a legal conclusion to the effect that defendants Peter Bercut and Henri Bercut are lawfully possessed of the shares of Merchants Ice received by them pursuant to the transaction of Janauary 8, 1941, and that the said transaction was in every respect a lawful, corporate act, binding upon the Holding Company, lawfully negotiated and consummated and hence did not constitute any conversion of the shares by the defendants. In essence, they are conclusions of law and not *findings* of ultimate facts.

These two findings, we assume, are directed to the second and third count of plaintiff's complaint, and an attack on the correctness of these two findings is really an attack on the propriety of the conclusions of law and judgment of the trial Court. This we shall do in our discussion under Point No. 8, *which point is the essence and gist of our appeal.*

POINT No. 8.

The conclusions of law and judgment of the trial Court are erroneous, not based upon any proper find-

ing of fact, and contrary to the law and equity of the case, on the following three main legal and equitable grounds.

(a) The transaction of January 8, 1941, was not a valid, corporate act, legally binding upon Pacific Empire Holdings, Inc., its stockholders, creditors or receiver.

The by-laws of the corporation, in force and effect at the time of the transaction prescribing the powers and authority of the board of directors, the executive committee and the officers are cited herein under Part I of the appendix and set forth in full at pages 74p to 75i of the Record.

The five minute books of the Holding Company and of Empire Corp. in evidence (Pl. Ex. 2, 3, 4, 5, 6) clearly disclose that, on any matter or proposal of any importance, it was customary for the executive committee or board of directors of these corporations to meet, either in special session or by written waiver of notice and consent, for the purpose of passing upon, authorizing or ratifying any substantial transaction. The minutes will conclusively show that such proceedings were always had when it came to questions involving purchases or sales of any property; borrowing or lending of money; pledging of assets; or execution of guarantees or other obligations. If authority to do a certain transaction was not obtained prior it was, in every case, subsequently ratified by proper minutes and resolutions in the minute books. The minute books in evidence conclusively so indicate. (See

testimony of Maffei, R. 122, 132, 143, 153, 157, 163, 165, 167, 168, 175, 188, 189, 192 and 193.)

In the case of the Bercut transaction, however, *it is admitted that at no time has the executive committee, as a committee, or the board of directors, as a board, ever authorized, ratified or even considered the matter.* It is admitted (and heretofore discussed) that the stockholders have never been advised of the sale of the principal asset of their corporation, an asset carried on their books at more than $650,000, constituting practically the only substantial asset of the company, and without which the company was practically out of business—and certainly insolvent. It is admitted that the only directors (of which there were then seven) who knew about the deal with Bercut were the defendants Maffei, Arnold and Bercut. Even director Webb Richards, *called as a witness by and on behalf of defendant Bercut,* testified that the first time he learned of the true facts of this deal was at the meeting of the board of directors, held August 20, 1942, which meeting was the first meeting of the board after the consummation of the Bercut deal, and at which meeting the board, *at its first opportunity, upon learning of the deal,* repudiated the transaction by consenting to the appointment of a receiver in equity whose immediate purpose was to proceed to attempt to recover from Bercut the shares of stock delivered to him by Maffei and Arnold. This repudiation was consistent with and pursuant to the power reserved

to the board of directors by virtue of Article VII, Sections 1 and 2 of the by-laws (R. 74w), dealing with the appointment and powers of the executive committee.

Certainly it cannot be argued that the president and secretary of this corporation had, by virtue of their office, the power, in their discretion, to dispose of substantially the only asset of the corporation. Such an argument would be not only contrary to the by-laws themselves—it, in fact, would be contrary to law itself and to all the reported cases and opinion of learned authors.

As a general rule, the president of a corporation has no authority, merely by virtue of his office, to effect a sale or encumbrance of any substantial part of the real or personal property of the corporation, and certainly not a general conveyance of the assets of the corporation.

See:

13 *Am. Juris,* (corporations), Sec. 904 page 882, and cases there cited;

Maryland Finance Corporation v. Duvall (C.C. A. 4th), 284 Fed. 764;

DeLaVergne Ref. Machine Co. v. German Savings Inst., 175 U.S. 40, 44 L.Ed. 65, 20 S.Ct. 20;

14 *L. R. A.* 358, 359.

The generally accepted rule of law with respect to the power of a president of a corporation is well ex-

pressed in Section 655 of 6a *Cal. Juris*—on corporations, where, on the authority of numerous cited decisions by our Courts, it is stated as follows:

> "Although the president of a corporation is the presiding officer of the board of directors, he has, merely by reason of holding such office and in the absence of conferred or ostensible authority, no more power of management or disposal over the property and affairs of the corporation than any other single member of the board. 'The general powers usually vested in the office of president' conferred by a by-law, do not give general power to make contracts for the corporation. He has no power, merely because he is president, to bind the corporation by contract, but rather only such power as has been given him by the by-laws and by the board of directors, and such other powers as may arise from his having assumed and exercised authority in the past with the apparent consent and acquiescence of the corporation, or which are in the ordinary course and conduct of its business. *Thus, the president, merely by virtue of his office, has no power to mortgage corporate property, or alienate such property, or make executory contracts of sale binding upon its real property.*" (Italics ours.)

In *Andrew Jergens Co. v. Woodbury, Inc.*, 273 Fed. 952 (D.C. of Delaware, 1921), it was held that the president of an ordinary corporation has no power to enter into a contract the effect of which is to substantially divest the corporation of all of its assets.

In *Angelus Securities Corp. v. Ball, et. al.,* 20 Cal. App. (2d) 423, which is one of the latest expressions of our Appellate Courts (on a set of facts substantially similar to those presented in this appeal and dealing with a Delaware corporation doing business in California) we find the following statement at page 430:

> "Appellant's first contention is that the securities here in question belonging to the corporation could only be delivered to Ball or Luton and Cruickshank upon authorization of the board of directors, and that there is in the record no evidence of such authorization. The Delaware General Corporation Law (sec. 9, chap. 15, Rev. Code, 1915, as amended), in so far as here applicable, provides: 'The business of every corporation organized under the provisions of this chapter shall be managed by a board of directors * * *' The corporation, therefore, could act only through the medium of the board of directors, as prescribed by the statutory mandate. The evidence fails to disclose that any express authority was ever given to Harriss to enter into the transaction that resulted in paying out the corporation's cash and securities. Also, the by-laws of the corporation gave to the president general and active management of the corporation, and to the treasurer the custody of the corporate securities in question. Luton and Cruickshank, who received the securities in question, occupied respectively these offices. These two officers, knowing that the securities in question had belonged to the corporation,

> seeing the endorsement of Harriss on the securities transferring them to Ball, must have known or should have known, by reason of their official positions with the corporations, that Harriss had no authority from the governing body, the board of directors, to divest the corporation of these securities."

As for the office of the secretary, it is elementary that, in the absence of special authority, it is purely ministerial.

Peter Bercut, being an officer, director and member of the executive committee of the corporation is, under the authority of *Bank of Wilmington v. Wollaston,* 3 Harr. 90 (Del. Ch.) *conclusively* presumed to have knowledge of the contents and provisions of the by-laws of the corporation, and of the powers, authority and duties of its officers. *He cannot exculpate himself by admitting, as he did on the witness stand* (R. 328), *that he would sign and approve minutes* without reading them or knowing their contents. In *Cutting v. Bryan,* 30 Fed. (2d) 754 (C.C.A. 9th, 1929), certiorari denied in 280 U.S. 556, it was held that where a director benefits from his own negligent inattention to the affairs of his corporation, he may be forced to do his duty by a Court of Equity which can order the corporation, which he is supposed to represent, to take some affirmative action as against him.

In *Dinsmore v. Jacobson,* 218 N.W. 700 (Mich. 1928) it was held that:

> "One who has agreed to act as a director cannot excuse himself from negligence on the ground that the books of the corporation as well as the offices were at such a distance from his home that it was difficult for him to gain personal knowledge of the affairs of the corporation."

As was stated in the very recent case of *Cowin v. Jonas et al.,* 43 N. Y. S. (2d) 468, the rule of law is that

> "Good faith on the part of the directors practically never excuses a violation of duty, particularly when that duty is of express statutory nature."

In *Hotaling v. Hotaling,* 193 Cal. 368, we have a case where the corporation had a board of *five* members. At a meeting of the board at which only *three* of the directors were present, a resolution was passed authorizing a conveyance of certain corporate real estate to one of the directors present at the meeting. An action to have the deed declared void was thereafter brought. At page 376 the Court states:

> "Regarding the corporation as a separate legal entity and the deed under which Richard claims as an attempted corporate act, it must, we think, be conceded to have been invalid, at least in its inception, for the reason that its execution was never effectively authorized by the board of directors of the corporation, in whom was vested the sole power to give such authorization. (Civ. Code, sec. 305; Gashwiler v. Willis, 33 Cal. 11 (91 Am. Dec. 607).)"

In the case of *Alta Silver Mining Co. v. Mining Co., etc.,* 78 Cal. 629, at page 632, it was held:

> "There is no corporate seal, and it affirmatively appears that there was no resolution of the board of directors. The president has not the power, by virtue of his office, to mortgage the property of the company (see generally Bliss v. Kaweah C. & I. Co., 65 Cal. 502); nor has the secretary such power by virtue of his office (Blood v. Marcuse, 38 Cal. 594; 99 Am. Dec. 435); nor have both together the power which neither has separately; nor have the stockholders such power. (Gashwiler v. Willis, 33 Cal. 12; 91 Am. Dec. 607.) The powers of a corporation must be exercised, and its property controlled, by its board of directors (Civ. Code, sec. 305); the decision of a majority of the directors, 'made when duly assembled,' being valid as a corporate act. (Civ. Code, sec. 308.) The board must be 'duly assembled'. (Harding v. Vandewater, 40 Cal. 78.) And their transactions should be recorded. (Civ. Code, sec. 377; Southern Cal. Ass'n v. Bustaments, 52 Cal. 192.) The directors when not acting as a board have not the necessary power. (Gashwiler v. Willis, 33 Cal. 18; 91 Am. Dec. 607.) The absence of a resolution of the board renders the instrument invalid. (Southern Cal. Ass'n v. Bustaments, 52 Cal. 192.)"

In *Citizens Securities Co. v. Hammel,* 14 Cal. App. 564, we have a case where a corporation had a board of *nine* directors. At an informal meeting of the board, *not called for the purpose,* at which meeting only *seven* directors attended, a resolution was passed

authorizing the pledging and mortgaging of certain personal property to a creditor as security for unpaid rent. In a subsequent controversy over the property between the mortgagee and a creditor of the corporation, the said mortgage was held invalid. At page 568 the Court states its reasons in the following language:

> "It must be conceded that the executive or managing officers of a corporation have not the authority, without instructions from the board of directors, to pledge or mortgage the property of the corporation for antecedent debts. Especially would this be true of one simply a director of such corporation. The right of the board of directors to pledge or mortgage the property even for antecedent debts must be admitted, but that such board may authorize such act it is necessary that they be in session at a meeting lawfully assembled. *Plaintiff relying, as it must, upon the right of possession, as conferred upon it by the board of directors, must affirmatively show facts from which such authority may be reasonably inferred.* Seven members of the board out of a total membership of eleven, notwithstanding they constitute a majority, would not have authority to pledge the property of the corporation for an antecedent debt, unless they were legally assembled for the purpose of transacting corporate business. There is nothing in the record to indicate that this board was so assembled at the time plaintiff claims the authority was given. *In addition to this, we are of opinion that some action in the nature of a resolution would be necessary*

in order to warrant an officer of the corporation in thus pledging corporate property. The resolution need not necessarily be spread upon the minutes, if actually passed, but a conversation simply between four members—the other three present not being shown to have participated therein, nor in fact to have been aware of such conversation—is far from showing any resolution or authority upon the part of the board." (Italics ours.)

In the case of *Ames v. Goldfield Merger Mines Co.*, 227 Fed. 292, we have a case singularly alike to the case at bar. The facts of the case, as briefly outlined in the headnotes, were found to be substantially as follows:

"The directors of a mining company met but four times in four years, and did not call a stockholders' meeting for more than three years, during which time the company expended $250,000 which was practically all of its available funds, and also sold property for $50,000 which a short time afterward was worth $500,000. All of such business was transacted without authority from the directors, by officers who were also officers or employes of other mining companies having the same majority stockholders. The work done was not calculated to, and did not, benefit the company, but did benefit the other companies."

At page 301 District Judge Neterer states the rule of law applicable to such a case to be:

"The stockholders of a corporation have a right to expect from their directors a conscientious con-

> sideration of every proposition which is presented which involves any interest of the company, in conformity to the oath which they have subscribed. They have a right to have the individual viewpoint of the several directors expressed at a conference, for the purpose of obtaining the exchange view of the several persons in arriving at conclusions after deliberate consideration of any issue. It is fundamental that officers of boards can only act as such constituted boards when assembled as such, and by deliberate and concerted action dispose of the issue under consideration, and that they cannot act in an individual capacity outside of a formal meeting."

It was consequently held that on such facts the minority stockholders were entitled to the appointment of a receiver for the corporation.

In the case of *In re Webster Loose Leaf Filing Co.,* 240 Fed. at page 779, we have a situation where a corporation managed by three directors agreed to give a chattel mortgage on all of its property to one of its directors to secure *an actual* loan of $10,000 made to the company by the mortgagee.

The evidence showed that no formal meeting of the board of directors was ever had to approve or authorize the execution of said chattel mortgage. At page 787 the Court states:

> "It appears therefore that this mortgage for $10,000 covering all the property of the corporation was authorized, not at any meeting regularly and legally called of the directors, but was the

result of a private agreement which Roberts and Webster made after discussing the matter from time to time as they met in the regular course of their business at the office of the corporation, or at the office of Roberts in New York, and Webster says this is exactly what happened. *If this be true, the mortgage in question therefore was never legally authorized, and is therefore invalid for that reason.*" (Italics ours.)

In *U. S. Fire Apparatus Co. v. G. W. Baker Machine Co.,* 10 Del. Ch. 421, 95 Atl. 294 (1915), it was held that the directors of a corporation must act as a board and not as individuals; that neither a quorum nor a majority can act in any way other than through a duly convened meeting and their individual consent to a contract without a meeting is not the consent of the board, and where there was neither a meeting of the directors of a corporation nor a resolution authorizing a sale it was held that such a transaction was void.

To the same effect as above is the case of *Mattoax Leather Co. v. Patzowsky,* 2 Boyce 327, 80 Atl. 241 (1911).

In *Bowen v. Imperial Theatres, Inc.,* 13 Del. Ch. 120, 115 Atl. 918 (1922), it was held that, where two directors authorized the issuance of stock of a company in consideration of a certain contract but the board consisted of three directors and in that case the third director had no notice and did not participate in the transaction, the said transaction was void for the

reason that the corporation was deemed entitled to the benefit of the judgment of the third director.

In *Bruch v. National Guarantee Credit Corp.,* 13 Del. Ch. 180, 116 Atl. 738, it was held that where the by-laws of a corporation provided that the board of directors shall consist of seven members and a majority shall be necessary to make a quorum the vote of three directors was deemed insufficient to authorize the president to file an answer admitting the allegations of a bill seeking the appointment of a receiver, *although in that case it was proven that there were four vacancies on the board.*

So much for the decided cases, but it is appropriate to observe here that the articles of incorporation of Pacific Empire Holdings, Inc. and the by-laws (in evidence) gave power to the board of directors to sell all of the property of the corporation *upon consent of the holders of a majority of the outstanding stock having been first obtained.* This provision is in accord with and follows Section 65 of the Delaware General Corporation Laws, which section requires such stockholders' consent. Now, it is elementary that the word "all" as used in such statutes does not mean *literally all* of the assets of a corporation, but means *substantially all* of the assets.

The learned Chancellor Wollcot, in his now famous opinion rendered in *Loft, Inc. v. Guth,* 2 Atl. (2d) 225, at page 245. Had occasion to pass upon the contention of the defendant, Guth, to the effect that the

board of directors of Loft, Inc. knew all about the transaction and had authorized him to take it in his individual capacity for the reason that the corporation was not financially able to take it itself. The Court disposed of this argument by showing that there was nothing in the records of the corporation to substantiate it and said:

> "The defendants contend that it is not indispensable to corporate action that a formal vote be taken by the directors and recorded in the minutes of their meetings. Accordingly, they say, the absence of any minute recording an authority to Guth to commit Loft to the financing of Pepsi, is not conclusive that no such authority was given. Knowledge on the part of the directors and their unrecorded consent, or even absence of objection on their part accompanied with knowledge that one is dealing with the corporation on the assumption of the corporation's agreement, the defendants contend, are as sufficient to bind the corporation as if its directors had adopted a formal binding resolution. The defendants cite cases in support of the proposition. *The cases so cited are in the main if not entirely cases involving the dealings of third parties with the corporation and therefore clearly not relevant to a case such as this, where the corporate dealings are with the corporation's director-president who is in complete control of its affairs and in a position of dominance over its board.*
>
> I shall not review those cases. It is not necessary for me to do so for this, if for no other reason, that my conclusion is that though some of the

directors knew that Guth was interested in Pepsi, none of them, excepting possibly Masters, who was treasurer, knew that Guth was drawing upon Loft for practically the entire financing of Pepsi. If they did know it and authorized it, they were clearly breachers of the trust confided to their keeping. Directors who either through friendship for the president of a corporation or for fear of his displeasure or for any other reason, authorize him to use the corporate resources committed to their management or control for the promotion of his own personal projects, are participants in a fraud. As they have no power to authorize the fraudulent acts, so they are equally devoid of power to ratify them. This court has held that a majority of even the stockholders has no power by ratification to bind the corporation to a fraud committed upon it by its officers and directors. *Eshelman et al. v. Keenan et al.,* Del. Ch. 187 A. 25. The authorities therein cited in support of the rule may be supplemented by Continental Securities Co. v. Belmont, 206 N.Y. 7, 99 N.E. 138, 51 L.R.A. N.S. 112, Ann. Cas. 1914A, 777; and *Smith v. Bunge,* 272 Ill. App. 182, affirmed, 258 Ill. 229, 193 N.E. 122. A fortiori it must be true that directors who authorized the wrong are without power to validate it by their own ratification." (Italics ours.)

In view of the foregoing authorities and hundreds of substantially similar decisions by the Courts of every jurisdiction, how can the Bercut transaction be possibly held to be a valid corporate act? Mr. Maffei, as president, and Mr. Arnold, as secretary, by

virtue of their office, had no power or authority to dispose of substantially the only real asset of the corporation. Such a transaction certainly does not come within the general scope of their power or authority. The by-laws did not vest them with any such authority. The usual course of business of the corporation, as shown by the minute books in evidence, denies to them any such authority. The three directors who constituted the executive committee merely agreed, informally, among themselves, to transfer this most valuable asset to one of themselves, without saying a word to anyone else, and without even taking the precaution of at least calling a meeting of the committee which they constituted, or of making a note of the transaction in the minute book of the corporation.

The defendants argue that, in view of the fact they constituted the executive committee, why bother about such a simple proposition as calling a meeting just for the purpose of passing a resolution and making it a part of the minute book. Is it not sufficient, so they contend, that the three of them put their signature on the document dated January 8, 1941? It is fortunate for the creditors and stockholders of corporations generally that the Courts of every jurisdiction have consistently refused to lend any support to such specious, if not actually dangerous, reasoning, otherwise plain and simple larceny and embezzlement of corporate property by corporate officers would automatically become legal by their mere execution of a paper, in the name of the corporation, to themselves,

followed by their own ministerial affixment of the corporate seal.

But, by way of irrefutable answer to such an illogical and legally unsound argument, we need only point out that when Peter Bercut elected to take his chances on the assumption that the transaction had been approved, though informally, by the executive committee, he did so with the knowledge that under the by-laws the board of directors, at its next meeting, had the right to disaffirm the acts of the so-called executive committee. Giving to Bercut all of the benefits of his most unsalutary contention—the undisputed facts in this case are—that the corporation's board of directors, at the first meeting held thereafter, namely, August 20, 1942, at the very first opportunity presented to the board, emphatically disaffirmed the deal by its approval of the appointment of a receiver for the company whose first act was to repudiate the deal and seek to recover for the company this most valuable asset.

Hence, we respectfully submit that the defendant Peter Bercut and his brother Henri Bercut, his partner in the deal (R. 390), have acquired no valid title to the stock in issue as the result of the January 8, 1941 deal.

(b) The January 8, 1941 transaction is void because it constitutes a flagrant breach of trust by fiduciaries.

The case at bar is unique in that in none of the hundreds of reported cases, dealing with breaches of fiduciary duties by corporate officers or directors, have we been able to find one so flagrant, so brazen and cold blooded in character.

The evidence adduced at the trial of our case has disclosed a systematic looting, over a period of years, of every corporation which came under the baneful influence of the defendants. Not a single corporation with which the defendants Maffei, Arnold and Peter Bercut had anything to do was left unstripped. The cold bloodedness with which these men disposed of the assets of Pacific Empire Holdings, Inc., Pacific Empire Corporation, Merchants Ice and Cold Storage Company, California Pacific Service, Inc. *and even the trust assets belonging to the stockholders of the City National Bank, in course of liquidation, is appalling.* The story of their systematic depredations, unfolded in Court, was and is almost unbelievable. Creditors and stockholders, as far as these men were concerned, were mere unavoidable nuisances. And throughout the entire history of corporate looting disclosed to the Court we find the defendant Peter Bercut to be one of the small, intimate group of directors actually managing these corporations. Maffei, Arnold and Bercut constituted the trio operating and mismanaging these companies. Nor can

Peter Bercut exonerate or exculpate himself by taking the witness stand and testifying that, although his bookkeeper had advised him the financial reports of these companies were "bogus" (R. 329), nevertheless he would sign and approve minutes of meetings of board of directors and of executive committees (at which, he says, he was not present or were not held) without even reading them. (R. 327.)

As ultimately happens in all such cases, these faithless trustees and the corporations managed and looted by them, came to the inexorable end of their tortuous road. They finally found themselves in the trap which they had inadvertently created for themselves. On November 20, 1940, the United States obtained a judgment against Pacific Empire Holdings, Inc. for a sum in excess of $11,000. The company had no assets left, other than shares in subsidiaries, which had likewise been looted and left devoid of any assets, and a block of 12,495 preferred and 65,863 common shares of Merchants Ice and Cold Storage Company. These men knew that an execution issued upon said judgment and levied on the shares of Merchants Ice and Cold Storage Company would result in the control of this company passing to "unfriendly hands", followed by an exposure of their systematic depredations.

So the defendant, L. R. Arnold, who in the meantime had caused himself to be denominated "executive vice president" and, who, at the time, was also presi-

dent of Merchants Ice and Cold Storage Company, and personally responsible for the juggling of the books of that company, hastened, "under pressure", as he termed it, to place the more than 78,000 shares of Merchants Ice and Cold Storage Company into the hands of one who, not only had money and could rehabilitate that company, but one who could be relied upon not to be unfriendly to Arnold and Maffei. That man, possessed of these indispensable qualifications, was Peter Bercut, their intimate associate, since 1930, in the mismanagement of these companies.

It is obvious, to even a schoolboy, that, to L. R. Arnold and Maffei, it had become imperative that Peter Bercut take over the controlling interest of Merchants Ice. Only in that way could they reasonably expect at least a deferment into the future of the inevitable consequences of their misconduct. Irrespective of what defendant L. R. Arnold says about the "pressure" which compelled him to finally accept the "generous and magnanimous" offer of $35,000 made to him by Peter Bercut, for an asset valued at over $650,000, and *then* reasonably worth at least $300,000, it is obvious that the motivating pressure was the imperative necessity of having a "friend" in charge of Merchants Ice. That is the only possible reason why they did not even deem it advisable to talk to anyone else about the deal, or seek to obtain from other interested parties a better price for the block. Why, at the time they owed Kohler & Chase (a very

wealthy concern) almost $15,000 in back rent, and although they had been told by Mr. Chase that he was interested in acquiring this block of Merchants Ice stock, should it be decided to sell it, nevertheless they studiously kept away from him, even though Arnold and Maffei admit that Bercut's offer was not at all satisfactory to them. (R. 875, 231.)

Why the hurry to close with Bercut? Why the secrecy? Why the failure to try to obtain a better price from other sources? Simply and purely because they felt it would be inadvisable to let the control of the company pass into the hands of anyone who might be inclined to bring them to account.

Defendants Maffei and Arnold felt safer in dealing with Bercut. He had been one of them. He knew the terrible financial plight of all these companies. He had money and credit and he could reasonably be expected not to be unfriendly. In other words, to Arnold and Maffei, it became apparent that by putting this block of stock in the hands of Peter Bercut, instead of a stranger, their house of cards might yet not collapse upon them.

And as for Peter Bercut, why he knew well the situation. For years he had gone along with them, watching the looting and mismanagement going on without protest. (R. 327.) On the contrary, he would sign and approve transactions without even going to the meetings or reading the minutes. He well knew that sooner or later they would have to come to

him (R. 337), since he was the only one in the family with plenty of money and credit.

So, when around November 20, 1940, the defendant L. R. Arnold finally approached him with a proposal for him to take over a half of the holdings of Pacific Empire in Merchants Ice, he, Peter Bercut expresses no interest. But eventually he makes an offer of $35,000 for the whole block—because—so he testified, he had to have the *control* of Merchants Ice, or nothing. (R. 341.) At this point he completely forgot that he was then and there a fiduciary of all these companies. *He completely forgot that, as an officer and director of all these companies, and as a member of a small executive committee, he owed the duties of a trustee to the creditors and stockholders of all these companies.*

He cared nothing for them. He admitted on the stand that these companies were busted anyhow—and had been for a long time—and the creditors and stockholders of these companies had nothing coming anyhow. (R. 337.)

So, caring only for Peter Bercut, and being exclusively desirous of acquiring this block of stock—at the very lowest possible figure (instead of being insistent that the corporation dispose of the stock at the highest obtainable price) he finally offered $35,000 to Arnold, of which sum, he required that $25,000 be immediately paid back to *his* new company, Merchants Ice. And when Arnold asked for more

—why—Bercut went south for a vacation. (R. 848.) When he came back his offer was still the same, and Arnold and Maffei, being then "under pressure" (though Mr. Gaither of the Pacific National Bank testified that there was no pressure from his bank where all the loans were then carried) hastily dictated to Peter Bercut a letter, under date of January 8, 1941, placed the name of Pacific Empire Holdings, Inc. at the bottom, then Maffei signed as president, Arnold signed as secretary and the corporate seal was affixed. *Peter Bercut was in such a hurry that he did not even sign where he was supposed to sign—under the word "accepted".* (Pl. Ex. 22, R. 224.) *But he did receive the stock* and the evidence discloses that Pacific Empire Holdings, Inc. received the *net* sum of about $4000 from the deal; some of which was used to pay a part of the back rent due to Kohler and Chase, and the balance, we suppose, must have gone to pay the salaries of defendants Maffei and Arnold.

Mr. Bercut thereupon takes over the management of Merchants Ice—the stock becomes his—and creditors owning $300,000 in claims against the holding company, including the United States government, and more than 8000 stockholders are left holding the bag. Immediately thereafter Merchants Ice starts to make and thereafter continues to make greater and greater profits. So much so that the stock of Merchants Ice acquired by Bercut from the holding com-

pany is now considered by him to be so valuable that he would not say on the witness stand whether he would take one million dollars for it. He said he would not sell it, because—so he said, "he owed a duty to his stockholders". (R. 344.) It is remarkable that all of a sudden Peter Bercut should feel any duty to his stockholders considering how callously and ruthlessly be discharged his fiduciary duties toward the stockholders and creditors of Pacific Empire Holdings, Inc. and Pacific Empire Corporation.

The extent of his consideration of the rights of his creditors and stockholders is expressed in the so-called "option" given by him to the company to reacquire from him, within two years, 20,000 shares of *common* stock at 50 cents a share. Knowing full well that the company had no assets left, after the deal, with which to exercise such option, he took the *precaution* of providing that it should be *non-assignable* and, to make doubly sure that the option should never be exercised, he provided that the voting rights as to such 20,000 shares should remain, in any event, with him for seven years. This was the extent to which the defendant Peter Bercut felt he should go in discharging his fiduciary obligations to the creditors and stockholders of the companies of which he was an executive officer and director. (R. 874, 232.)

We repeat, such a brazen, flagrant and calculating breach of trust on the part of a fiduciary has not

been observed by any of the writers of this brief in any of the reported cases. In our humble opinion the transaction, which is the subject of this cause, is one that not only is invalid *per se*—but is of the class generally cognizable in the criminal Courts. (See *Italo Petroleum etc. v. Hannigan,* 40 Del. 534, 14 Atl. (2d) 401.)

We have not been able to discover a reported case in all the law books that would support a corporate transaction of this character. All the text writers of corporation law emphatically condemn them. The decisions of our state and federal Courts are unanimous in refusing to give to such transactions any color of legality.

Let us examine just a few of the leading decisions bearing upon this aspect of the case.

Undoubtedly one of the leading cases on this phase of the law is *Guth v. Loft, Inc.,* 5 Atl. (2d) 503 (affirming in toto the opinion of the Chancellor rendered in *Loft, Inc. v. Guth,* 2 Atl. (2d) 225). The case dealt with a bill in equity, described in the opinion of the Chancellor as follows:

> "Briefly described, the gravamen of the bill is that Guth, while he was the president and the controlling influence in Loft, Inc., caused a certain very desirable business proposition which was made to him as the president of the complainant, to be diverted from the complainant to a newly formed corporation, the defendant Pepsi-

> Cola Company, most of the shares of the capital stock of which he and his personal holding corporation, the defendant The Grace Company, acquired."

The complaint sought to have a judgment of the Court decreeing that all of the stock of Pepsi-Cola Company then directly or indirectly owned by Guth and Grace equitably belonged to Loft, Inc. It was also prayed that the defendants be ordered to account for any profits earned by them as the result, during the period of time, of their holding the Pepsi-Cola stock in their name.

Chief Justice Layton, in affirming the decision of the Chancellor awarding judgment to the plaintiff, in the course of his opinion, at page 510, stated as follows:

> "Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protest the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to

the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or enable it to make in the reasonable and lawful exercise of its powers. The rule that required an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest. The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale.

"If an officer or director of a corporation, in violation of his duty as such, acquires gain or advantage for himself, the law charges the interest so acquired with a trust for the benefit of the corporation, at its election, while it denies to the betrayer all benefit and profit. *The rule, inveterate and uncompromising in its rigidity, does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation. Given the relation between the parties, a certain result follows; and a constructive trust is the remedial device through which precedence of self is compelled to give way to the stern demands of loyalty.* Lofland et al. v. Cahall, 13 Del. Ch. 384, 118 A. 1; Bodell v. General Gas & Elec. Corp., 15 Del. Ch. 119, 132 A. 442, affirmed 15 Del. Ch. 420, 140 A. 264; Trice et al.

v. Comstock, 8 Cir., 121 F. 620, 61 L. R. A. 176; Jasper v. Appalachian Gas Co., 152 Ky. 68, 153 S. W. 50, Ann. Cas. 1915B, 192; Meinhard v. Salmon, 249 N. Y. 458, 164 N. E. 545, 62 A. L. R. 1; Wendt v. Fischer, 243 N. Y. 439, 154 N. E. 303; Bailey v. Jacobs, 325 Pa. 187, 189 A. 320; Cook v. Deeks (1916), L. R. 1 A. C. 554.

"The rule, referred to briefly as the rule of corporate opportunity, is merely one of the manifestations of the general rule that demands of an officer or director the utmost good faith in his relation to the corporation which he represents."

The case of *Guth v. Loft,* supra, was cited with approval by Mr. Justice William O. Douglas in the case of *Pepper v. Litton,* decided in 1939, reported in 308 U. S. 295. At page 306 of the opinion Mr. Justice William O. Douglas lays down a statement of law which would seem to preclude, on its face, any legal or equitable right on the part of Peter Bercut to the stock of Merchants Ice & Cold Storage Company in question. The statement is as follows:

"A director is a fiduciary. *Twin Lick Oil Co. v. Marbury,* 91 U. S. 587, 588. So is a dominant or controlling stockholder or group of stockholders. *Southern Pacific Co. v. Bogert,* 250 U. S. 483, at 492. Their powers are powers in trust. *Jackson v. Ludeling,* 21 Wall. 616, at 624. Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is chal-

lenged, the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. *Geddes v. Anaconda Copper Mining Co.,* 254 U. S. 590, 599. The essence of the test is whether or not under all the circumstances it carriers the earmarks of an arm length's bargain. If it does not equity will set it aside. While normally the fiduciary obligation is enforceable directly by the corporation, or through a stockholder's derivative action, it is in the event of bankruptcy of the corporation, enforceable by the trustee. For the standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation; creditors as well as stockholders." (Citing authorities.)

And, at page 311, at the end of his opinion, Mr. Justice William O. Douglas lays down what he considers to be the commandments binding upon a corporate officer and director, namely:

"He who is in such a fiduciary position cannot serve himself first and his cestuis second. He cannot manipulate the affairs of his corporation to their detriment and in disregard of the standards of common decency and honesty. He cannot by the intervention of a corporate entity violate the ancient precept against serving two masters. He cannot by the use of the corporate device avail himself of privileges normally permitted

outsiders in a race of creditors. He cannot utilize his inside information and his strategic position for his own preferment. He cannot violate rules of fair play by doing indirectly through the corporation what he could not do directly. He cannot use his power for his personal advantage and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements. For that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the cestuis. Where there is a violation of those principles, equity will undo the wrong or intervene to prevent its consummation."

We respectfully submit that the defendants, especially Peter Bercut, have, under the evidence of the case, violated every one of Mr. Justice Douglas' precepts, and it is now for this Court, sitting as a Court of Equity, to carry out the last commandment.

The decision of Chancellor Wollcot in *Guth v. Loft,* supra, was also cited by Chief Justice Layton of the Delaware Supreme Court in the very recent case of *Italo Petroleum Corp. v. Hannigan,* 40 Del. 534, 14 Atl. (2d) 401, in support of his reversal of a judgment obtained against the corporation in the lower Court.

In the well reasoned case of *Garden Valley Development Co. v. Warren Ranch* (Sup. Ct. of Arizona), reported in 276 Pac. 839, we have a situation where a stockholder brought suit to cancel a lease obtained from the corporation by another corporation in which latter the president of the lessor corporation was financially interested. The suit to cancel the lease was based on the claim that it was grossly unfair to the lessor corporation. In discussing the principle of law involved, Chief Justice Lockwood, at page 842, states:

> "We come, then, to the vital issue of the case. Was the lease, under all the circumstances appearing in the evidence, of such a nature that as a matter of law it is voidable at the suit of plaintiff? There are three rules prevailing in regard to the validity of transactions wherein the director of a corporation participates and has a personal interest therein. The first is that all such, regardless of their fairness, are subject to rescission at the suit of any stockholder. Morgan v. King, 27 Colo. 539, 63 P. 416; Transvaal Lands Co. v. New Belgium Land & Development Co. (1914), 2 Ch. Div. 488-503; Purchase v. American Safe, etc. Co., 81 N. J. Eq. 344, 87 A. 444. The second is that unless the transaction was authorized by the majority of a wholly disinterested quorum the transaction will be set aside. In other words, if the vote of the interested director was necessary to constitute a quorum or to pass the resolution, the transaction may be voided, regardless of its fairness. Curtin v.

> Salmon River, etc. Co., 130 Cal. 345, 62 P. 552, 80 Am. St. Rep. 132; Sacajawea Lumber, etc. Co. v. Skookum Lumber Co., 116 Wash. 75, 198 P. 1112; In re Webster Loose Leaf Filing Co. (D. C.), 240 F. 779-785. The third rule, which has been approved by this court, is that the transaction will be closely scrutinized and will be set aside upon the slightest evidence of unfairness. Dragoon Marble, etc. Co. v. McNeish, 28 Ariz. 96, 235 P. 401; Phoenix Title & Trust Co. v. Alamos Land & Irrigation Co., 24 Ariz. 499-506, 211 P. 570-572."

In conclusion, the Chief Justice found that the lease was unfair to the stockholders of the lessor corporation, and he held, therefore, that even under the lenient rule adopted by the Court, it was properly cancelled.

In *Frankford Exchange Bank v. McCune,* 72 S. W. (2d) 155, a decision by the Supreme Court of Appeal of Missouri, we have a case where the Finance Commissioner (who had taken over plaintiff bank above named on its insolvency) brought suit against the directors of the bank to recover certain assets of the bank turned over to its seven directors to indemnify them against loss for their having gone surety on one of the bank's bond. To become depository of county funds, the bank had to give the county a bond. The evidence disclosed that after using corporate surety for several years, the bank, in order to

save bond premiums, induced the directors to go bond for the bank, and it pledged to the directors assets sufficient to protect them.

The trial Court found there had been absolute good faith and no fraud, and that the suretyship had been undertaken by the directors on express understanding of guarantee; that the bank received benefit from the action and would suffer no detriment if defendants' title to the assets was affirmed. Nevertheless, the Court invalidated the agreement because of the personal interest of the directors in the contract, and gave as its reasons for setting the transfer aside, as follows (page 158):

> "In this particular case it is very likely true, as the lower court found, that defendant had no idea of defrauding the bank, and in fact undoubtedly thought that they were aiding it (though at no risk to themselves), but nevertheless they were drawing assets from the bank which belonged to it, and were securing for themselves a preferred status in contravention of the rights of others, who, upon the bank's failure, were equally entitled to look at the same assets as security for their own claims. Of course, it is true that in the present situation the general creditors of the bank are no worse off than they would have been if government or state bonds of equal value had been pledged with the county by the bank, as it would have had the right to have done. *But be this as it may, the law, in placing its*

stamp of disapproval upon the maintenance of inconsistent positions by corporate officers, does not pause to inquire whether the contract or transaction was fair or unfair, nor does it undertake or attempt to consider the question of abstract justice in the particular case. Rather, it stops its inquiry when the inconsistency of position is disclosed; it sets aside the transaction, or refuses to countenance it, when it is the product of a dual undertaking; and thus, in so far as may be, it prevents the accomplishment of frauds by making them impossible at the outset." (Italics ours.)

It should be noted, however, that even in those cases where the contract is held to be valid if entered into fairly and in good faith it is universally held that the dealing between the corporation and the interested director must be at arm's length, and there must be a proper corporate action on the proposition followed by specific authorization by the board of directors acting formally without counting the vote of the interested director. Thus in *Veeser v. Robinson Hotel Co.,* 275 Mich. 133, 266 N. W. 54, it was held that the rule which permits a director of a corporation to deal with it even in good faith, is *limited* to those cases where the corporation is represented by a quorum of disinterested directors or other independent officers or agents *authorized* to contract for it. *This rule of law is likewise the California rule. See Union Die*

Casting Co. Ltd. v. Andersen (1938), 25 C. A. (2d) 195 at 201, and Sec. 311 of *Civil Code.*

In *San Francisco Water Co. v. Pattee,* 86 Cal. 623, the plaintiff water company was only semi-active; the financial condition necessitated periodic contributions by the officers for taxes and bills, no assessment being levied. Defendant was its secretary. He claimed he resigned in August, 1878. Plaintiff claimed he was active till January, 1881. In 1878 the company had debts and no funds. The officers refused to assess or contribute further. They authorized borrowing but no loan could be obtained. Defendant told the president and the attorney, who was also a director, in August, 1878, he would no longer act as an officer and director, and made a pencil entry in the books of his resignation, but it was not acted upon.

At an execution sale held on a judgment obtained by a creditor against the corporation, the defendant, by his agent, bought in the property.

No one but the attorney, who was sold a one-half interest in the property at cost, was told of these matters until January 4, 1881, when at a meeting of the directors the defendant disclosed the facts. His purchase was repudiated and a tender of his expense was made and refused.

The Court impressed the property acquired by the defendant, as aforesaid, with a trust and directed him

to reconvey the property to the corporation. At page 629 the Court said:

> "It is also claimed for this defendant that his relations to the company were not of a fiduciary character, and that even if they were, he was not for that reason forbidden by law to buy in the property for his own benefit, at a forced sale not made by himself or at his instigation."
>
> "The terms of the by-laws make him in large degree the general agent and manager of the corporation. The supervision of nearly all its affairs was committed to him, and the evidence shows very conclusively that during many years, while the corporation was in a state of inactivity, he was its head and front; it had no knowledge of its own affairs except as he gave it, and met or moved only as and when he suggested. He was therefore bound to act towards the corporation in the highest good faith, and was not at liberty to obtain any advantage over the corporation by concealment from its directors of the true condition of its affairs. (Civ. Code, sec. 2228.) Under section 2230 of the same code he had no right to take part in any transaction concerning the property of the corporation, all of which was practically in his keeping, adverse to the interests of the company, without the consent of its directors, given upon full knowledge of the facts. If he did so, it was a fraud against the company (sec. 2234) and if by doing so he acquired any interest adverse to the interest of the company, it was his duty to give immediate in-

formation thereof. (Civ. Code, sec. 2233. See also Baker v. Whiting, 3 Sum. 475.)"

To the same effect as the foregoing cases are:

Kahle v. Stephens, 214 Cal. 89;

Pasadena Mercantile Finance Corp. v. De Besa, 122 Cal. App. 575;

Union Die Casting Co. v. Anderson (1938), 25 Cal. App. (2d) 195 at 201.

Turning now to our own local Federal District Court, we have the leading and often approved opinion of Judge St. Sure, rendered in *Blum v. Fleishhacker,* 21 Fed. Sup. 527 (District Court, N. E. Calif. 1937).

With respect to the question of burden of proof, we again cite *Veeser v. Robinson Hotel Company* (supra) (Sup. Ct. of Michigan, 1936), 266 N. W. 54, where the Court, in setting aside a transaction between two directors on one side and the corporation on the other, at page 55, remarked:

"The directors of a corporation stand in a fiduciary relation to the corporation and to its creditors. They may deal with it if their acts are open and above board and known to the directors, and the director dealing with the corporation is not in control thereof. Barnes v. Spencer & Barnes Co., 162 Mich. 509, 127 N.W. 752, 139 Am.St. Pre. 587; Quinn v. Quinn Mfg. Co., 201 Mich. 664, 167 N.W. 898; Patrons' Mutual Fire Ins. Co. v. Holden, 245 Mich. 493, 222 N.W. 754.

The statute provides that no contract made with any director shall be invalid because of that fact alone. Act No. 327, Sec. 13, subd. 5, Pub. Acts 1931. *But when the validity of such contract is questioned, the burden of proving the fairness to the contracting parties of any such contract is upon such director, or other person, or group, or corporation, who asserts the validity of such contract.* Ibid.

The rule which permits a director of a corporation to deal with it, even in good faith, is limited to those cases where the corporation is represented by a quorum of disinterested directors or other independent officers or agent authorized to contract for it. 14a C.J. 119, 120. *And, even then, the burden of showing the validity of the contract and the fairness and honesty of the dealings of the director with the corporation is on him.* Patrons' Mutual Fire Ins. Co. v. Holden, supra." (Italics ours.)

Hence, we respectfully submit, on the strength of the foregoing authorities and universally accepted principles of law, that the transaction of January 8, 1941 was legally void as to the corporation.

(c) The transaction of January 8, 1941 is void because it constitutes a flagrant fraud on creditors.

Our Civil Code Section 3439.04 (enacted June 20, 1939 as part of the Uniform Fraudulent Conveyance Act) provides that:

> "Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration";

and Section 3439.07 of the Civil Code provides:

> "Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay or defraud present or future creditors, is fraudulent as to both present and future creditors."

There certainly can be no dispute as to the fact that upon there having been delivered to Peter Bercut the block of Merchants Ice shares owned by Pacific Empire Holdings, Inc. said corporation automatically became insolvent. The evidence discloses that at the time the corporation had approximately $300,000 in debts, including a *judgment* claim in excess of $11,000 obtained by the United States for unpaid taxes. The evidence is also conclusive that with the transfer of the Merchants Ice shares to Bercut the corporation's remaining assets were nominal while its subsidiary, Pacific Empire Corporation

retained in its portfolio, as its only asset (other than pledged shares of Pacific National Bank of San Francisco) the uncollectible notes of the holding company. It cannot be denied, we take it, that the insolvency of Pacific Empire Holdings, Inc. resulted directly from its parting with its investment in Merchants Ice and Cold Storage Company, for a *nominal* consideration.

Furthermore, the evidence disclosed that the true motivating "pressure" compelling the making of the deal was the fact that, as the defendant Maffei testified, they were very much worried over the judgment obtained against the company by the United States on November 20, 1940, a judgment which the company could not pay other than by a disposal of the Merchants Ice stock. Such being the undisputed facts, the transfer of this block to Peter Bercut for a nominal consideration cannot be looked upon other than a deliberate act intended to and which resulted in defrauding the government of the United States out of the benefits of its judgment lien. And since Peter Bercut was then an officer, director and member of the executive committee he stands tainted with the same degree of fraud as the defendants Maffei and Arnold. See *Rossen v. Villanueva,* 175 Cal. 632. One is guilty of fraud as to his creditors in doing that which the law deems fraudulent, even though he may not be conscious of the fact that he is committing any wrong. See *Sukeforth v. Lord,* 87 Cal. 399, at 408; 25 Pac. 497.

It has been held that a transfer, not in the ordinary course of business, made by an insolvent, whose condition is known to the transferee, is sufficient to place upon the parties to the transfer the burden of proving that it was not fraudulent. (See Sec. 31 of 12 Cal. Juris. on Fraudulent Conveyances, for the cited authorities and rule of law.)

It has also been held that inadequacy of consideration may be coupled with other circumstances so compelling in their nature that the inference of fraudulent intent is irresistible. See *Denehy v. Stewart,* 41 Cal. App. 88, at page 98; 181 Pac. 839. These circumstances are generally denominated as "badges of fraud" and the rule is well expressed in Sec. 133 of 27 Corp. Juris. on Fraudulent Conveyances in the following words:

> "There are circumstances so frequently attending conveyances and transfers intended to hinder, delay and defraud creditors that they are denominated 'badges of fraud'. These 'badges of fraud' do not in themselves or per se constitute fraud, but are rather signs or indicia from which its existence may be properly inferred as matter of of evidence". (Citing cases, among them Los Angeles Commercial Nat. Bank v. Roberts(a) 194 P. 751.)

What are some of the "badges of fraud", the concurrence of several of which will make a strong case of fraudulent intent?

Inadequacy of consideration is one, and when the inadequacy is gross and is combined with other circumstances it may amount to proof of actual fraud. *Loring v. Dunning,* 16 Florida 119.

In the case of *Shelton v. Church & Others,* 38 Conn. 416, the Court, at page 420, held:

> "It is elementary law that 'in every instance where a creditor, or purchaser, obtains the estate of an insolvent debtor at under rate, there is a violent presumption of a secret trust and fraudulent intent' (1 Swift Dig. 275), and such presumption unless rebutted is conclusive."

In *Barrow v. Bailey,* 5 Fla. 9, it was held that where a vendor, who was largely indebted and embarrassed by the pressure of his creditors sold his entire estate, real and personal, to a friend at a price considerably less than the fair market value of the property and less than the sum of his debts, the conferences between the vendor and vendee being held in secrecy, and no appraisement by or reference to any third person being made on the question of value, *fraud should, in such a case be inferred.*

We have another "badge of fraud" when a transfer is made by one, while a suit or judgment is pending against him, especially so if it leaves the debtor without any estate or greatly reduces his property. See *Griggs v. Crane,* 179 Ky. 48, 200 S.W. 317.

It is a "badge of fraud" that a conveyance was made after the rendition of a verdict in favor of a creditor; and while a stay of proceedings was in force, or after a final judgment has been entered. See *Maasch v. Grauer,* 58 App. Div. 560, 690 N.Y.S. 187.

The conduct of a sale or transfer not in the usual course of business or in an unusual way is a badge of fraud. See *Rossen v. Villanueva,* 175 Cal. 632 at 636, 166 Pac. 1004.

So are secrecy and haste surrounding a transaction badges of fraud. (See Sec. 143 of 27 C. J. for a long list of authorities) and *Daugherty v. Daugherty,* 104 Cal. 221, 37 Pac. 889.

And one of the most compelling badges of fraud is a transfer by a debtor of all or nearly all of his property, especially so when he is rendered insolvent by the transaction. (See *Ballou v. Andrews Banking Co.,* 128 Cal. 562, 61 Pac. 102; *Daugherty v. Daugherty,* 104 Cal. 221, 37 Pac. 889; 27 *C. J.,* Sec. 146; *Dodson v. Cooper,* 50 Kan. 680, 32 Pac. 370.)

All of the foregoing badges of fraud are obvious in the transaction of January 8, 1941 with defendant Peter Bercut. So much so, that when coupled with the violent breach of fiduciary obligation and the improper corporate conduct herein shown and discussed, the conclusion is inescapable that, in addition to the failure of Peter Bercut to pay a fair consideration for the stock, there is also present an actual intent to

hinder, delay and defraud the creditors of Pacific Empire Holdings, Inc.

Such being the case the transaction is void as to these creditors of the corporation and a receiver in equity, as representative and trustee for the creditors, has the right and duty, in their behalf, to seek to recover the transferred property and its subjection to the claims of creditors. (See *Olney v. Tanner,* 18 Fed. 636; 27 *C. J.,* Secs. 125 and 126 on Fraudulent Conveyances; *Guth v. Loft* (supra); *Pepper v. Litton,* supra.)

POINT No. 9.

Judgment in this cause should be rendered in favor of plaintiff as prayed for in plaintiff's complaint.

(a) The findings of fact of the trial Court are reviewable by this Court and should be reversed.

This cause is essentially an equity case, notwithstanding the second and third count of plaintiff's complaint.

Findings in equity may be revised if against the weight of the evidence at the instance of the appellant, but not on behalf of the appellees if the revision of the findings carries with it a revision of the judgment. (*Morley Const. Co. v. Maryland Casualty Co.* (Mo. 1937), 57 Sup. Ct. 325, 300 U. S. 185, 81 L. Ed. 593, reversing (C.C.A.) 84 Fed. (2d) 522.)

Although the Appellate Court ordinarily attaches great weight to findings of a chancellor, *it is not bound by them,* and if, upon review of the evidence, the Appellate Court reaches contrary conclusion, it will, if the findings of the chancellor appear clearly wrong, give it its own conclusions and effect. (*McIntosh v. Leisk* (C.C.A. 5th 1938), 95 Fed. (2d) 164.)

Where findings are asserted to be without supporting evidence or contrary to evidence the Appellate Court is required to examine them, notwithstanding the presumption of correctness that attends concurrent fact findings by master and judge. (*In re Waters* (C.C.A. 5th 1938), 93 Fed. (2d) 196, 114 A.L.R. 1368.)

Plaintiff respectfully submits to the Court that the correct findings of fact and conclusions of law in this cause, reasonably deducible and warranted by the evidence of the case, are as proposed by plaintiff to the trial Court. (R. 904.)

(b) Plaintiff is entitled to judgment as prayed for in his complaint.

On the record and the law and equity of the case, as discussed under our Point No. 8, judgment should be rendered in favor of plaintiff for a restitution by the defendants Peter Bercut and Henri Bercut of all shares of Merchants Ice received by them from defendants M. Maffei and L. R. Arnold pursuant to the letter agreement dated January 8, 1941, and for an

accounting by the defendants for all profits resulting to them from said transaction. (*Loft, Inc. v. Guth* (supra), 2 Atl. (2d) 225; *Blum v. Fleishhacker* (supra), 21 Fed. Supp. 527; *Pepper v. Litton* (supra), 308 U. S. 295; *Angelus Securities Corp. v. Ball* (supra), 20 Cal. App. (2d) 423; *Yamato v. Bank of Southern California,* 170 Cal. 351; *Yokohama Specie Bank v. Transoceanic,* 54 Cal. App. 533; *Los Angeles Drug Co. v. Superior Court,* 8 Cal. (2d) 70, 63 Pac. (2d) 1124.)

The rule of law applicable in this respect is well stated at Section 986 of 13 *Am. Juris.* (Corp.), at page 940, where, upon numerous cited authorities, it is declared:

> "The directors and officers of a corporation may be held liable to it for loss or injury consequent upon their unauthorized acts or contracts. There can be no doubt that if they do acts clearly beyond their power, whereby loss ensues to the corporation, or dispose of its property or pay away its money without authority, they will be required to make good the loss out of their private estates. This is the rule where the disposition made of money or property of the corporation is one either not within the lawful power of the corporation or, if within the power of the corporation, not within the power or authority of the particular officer or officers."

In proper cases a converter of goods can be held liable as a constructive trustee and not only for the

value, but also for the profits earned. (*Scott on Trusts,* Vol. 3, Sec. 508.1, at page 2434, and cases there cited.)

CONCLUSION.

We sincerely apologize to the Court for the length of our brief. Our justification is to be found in the nature and complexity of the case.

We respectfully ask the Court, after a full consideration of the record and our contentions, to reverse the judgment of the District Court and to direct said Court to enter judgment in favor of plaintiff on such terms and conditions as to this Court may seem meet, proper and just.

Dated, San Francisco, California,
January 5, 1944.

Respectfully submitted,
A. J. SCAMPINI,
ELLIS & STEINDORF,
C. T. HUBNER,
IVAN CULBERTSON,
Attorneys for Appellant.

(Appendix Follows.)

Appendix.

Appendix

PART I.

BY-LAWS OF HOLDING COMPANY IN FORCE ON JANUARY 8, 1941.

The following sections, among others, of the By-Laws of the Holding Company (R. 74p to 75w) were in force on January 8, 1941; and applicable to the issues involved in this case, viz.:

"ARTICLE IV—DIRECTORS.

Section 1. *Election.* The directors shall not be less than fifteen (15) nor more than twenty-five (25) in number and shall be elected by ballot at the annual meeting of the stockholders.

Section 2. *Term of Office.* Directors shall hold office for one year and until their successors are elected or appointed. Their term of office shall begin immediately after election.

Section 4. *Vacancies.* A vacancy shall be deemed to exist in the board of directors only whenever any director ceases to act as such by reason of his death, removal, or *resignation duly accepted,* etc.

ARTICLE VI—DUTIES OF DIRECTORS.

Section 6. *Management.* The board of directors shall manage and control the business of the corporation.

ARTICLE VII—EXECUTIVE COMMITTEE.

Section 1. *Appointment.* The directors may appoint an executive committee from their own number to consist of such number as they shall see fit.

Section 2. *Powers.* Any executive committee appointed by the board of directors shall have authority to exercise all the powers of the board of directors when said board is not in session, but subject to the immediate disaffirmance by the board at its next meeting after receiving the report of the acts done by said committee. Such committee may act by the written consent of all its members although not formally convened.

Section 3. *Removal.* Members of this committee may be removed as such and their successors may be appointed by the board and said committee may be abolished at any time by the board of directors."

The powers, authority and duties of the president, vice-presidents and secretary are set forth in Articles VIII, IX, X and XI of the By-Laws found at pages 74w to 74z of the record.

PART II.

FINANCIAL REPORT OF HOLDING COMPANY MAILED JUNE 30, 1940 TO THE STOCKHOLDERS. (Pl. Ex. 15, R. 205.)

Pacific Empire Holdings, Incorporated
26 O'Farrell Street
San Francisco

June 30, 1940.

To the Stockholders of
Pacific Empire Holdings, Incorporated:

This is the annual report of the management, covering the operation of your corporation for the year 1939, accompanied by the Consolidated Balance Sheet of the corporation at the close of business, December 31, 1939, as prepared by the Treasurer.

Merchants Ice and Cold Storage Company: The company, during the year 1939 enjoyed its largest volume of business since the year 1937, realizing during that period $65,381.05 of net profits from operations and before depreciation charges, representing the largest cash net income during many recent years included in its history of operation. Throughout the year, the company's condition became more sound and its net current position improved by approximately $65,000.00. The improved condition of the corporation was accomplished even though, effective October 31, 1939, the management, after long negotiations, was compelled to grant an increase in the wage scale for the majority of its employees, which will ultimately result in increased labor costs of approximately $15,000.00 annually. This development, together with the existing high interest rate on its bonded and other indebtedness, greatly re-

duces the net cash profits being earned by the company. Constant progress is being made toward remedying these latter conditions.

As set forth in this and preceding Balance Sheets of your corporation, the investment in the controlling stock of Merchants Ice and Cold Storage Company constitutes your corporation's largest investment. Consequently, all steps which have been taken since the reorganization to date, have been pointed toward placing this investment on a dividend basis. It is the opinion of the management that, after the elapse of another year's operation, the financial condition of Merchants Ice and Cold Storage Company will be such as to permit the company to work out certain financial readjustments affecting its bonded indebtedness and capital structure, whereby the payment of dividends will be made possible consistent with the net income which may be realized. Your corporation should then profit materially.

Frostcraft Packing Corporation: The acquisition of a substantial interest in Frostcraft Packing Corporation was previously included in the Balance Sheet for the year 1938. This acquisition was prompted by the opinion of the management of your corporation that an entry into the production of frosted foods was not only opportune from the standpoint of your corporation, but a constructive step in a field which should prove highly valuable and profitable to Merchants Ice and Cold Storage Company. The development of this corporation, during the year 1939, has reached the point whereby it is looked upon as one of the ten better nationally known companies producing and distributing frosted foods. While the company

has not yet progressed sufficiently since its organization to produce profits, nevertheless, it has already proven itself to be a valuable tenant and customer to Merchants Ice and Cold Storage Company.

Other Holdings and Investments: During the year 1939 there were no changes in your corporation's holdings in the stock of Pacific Empire Corporation, the bank stock holding company, excepting, however, that during the year, Pacific Empire Corporation disposed of 280 shares of its holdings of the capital stock of Pacific National Bank of San Francisco. The proceeds of this sale were utilized for the purpose of making additional loans to Merchants Ice and Cold Storage Company and to reduce the corporation's obligations owing to banks. The corporation continues to carry in its investments substantial holdings in the stock of Pacific National Bank, as reflected by the accompanying Consolidated Balance Sheet.

The investment in the stock of California Pacific Service, Incorporated continues to prove erates principally the Family Service Laundry at Bakersfield, California, enjoyed a gross volume of business for the year 1939 of $96,502.43. As heretofore reported, the operation of these properties has netted your corporation attractive annual profits consistently, since the acquisition of the stock of that company.

General: During the year under discussion, total liabilities of the corporation have been reduced by $53,581.82, including the reduction of $37,563.00 of notes payable to banks. Also during the year, even further economies have been ef-

fected by the management in general administrative and operating expense, with the result that the total expenditures of the corporation and consolidated subsidiaries, other than interest paid on obligations, equalled $8633.20. This figure represents a further reduction of overhead costs including all administrative charges and executive salaries of $4517.95.

The management, during the year, negotiated the cancellation of the lease on the premises occupied by the corporation and the change in the location of their offices, which will result in an annual saving of $4110.00.

As evidenced by the accompanying Balance Sheet, the management continues to increase its holdings in the stock of Merchants Ice and Cold Storage Company whenever the occasion warrants, thus improving its equity position, accordingly. This policy prevails toward any investment of your corporation, whenever it is possible to increase its majority holdings.

In concluding the report covering the 1939 operation of the corporation, the management wishes to state that the condition of the corporation and its controlled operating companies, has been greatly improved during these recent years, and further, that its foundation is sound to the end that the stockholders should ultimately benefit therefrom.

Respectfully submitted,

By Order of the Board of Directors,

L. R. Arnold,

Executive Vice-President.

M. Maffei,

President."

PACIFIC EMPIRE HOLDINGS

Incorporated

CONSOLIDATED BALANCE SHEET

as of December 31, 1939

After giving effect to adjustments to reflect the estimated fair or liquidating value of all assets owned by the Company

Assets

Investments:	
Capital Stock of Pacific National Bank	$ 82,176.65(A)
Preferred Stock of Merchants Ice and Cold Storage Company	123,456.66
Common Stock of Merchants Ice and Cold Storage Company	545,906.81(B)
Common Stock of Frostcraft Packing Corporation	10,000.00(C)
Capital Stock of California Pacific Service, Inc.	86,582.40(D)
Total Investments	$848,122.52
Cash on Hand and in Banks	6,677.89
Notes and Accounts Receivable, Less Reserve	33,387.26
Other Stock and Securities	10,197.85
Printing Plant; Furniture and Fixtures, Less Reserve for Depreciation	236.53
	$898,622.05

Liabilities

Notes Payable, Banks			$ 46,000.00(E)
Other Notes Payable			14,880.00(E)
Notes and Contracts Payable, Long Term Installment			56,858.20(E)
Accounts Payable			14,145.45(E)
Reserve for Contingencies			15,000.00(F)
Reserve for State Franchise and Federal Income Taxes			410.59
Minority Stockholders Interest in Capital Stock of Subsidiary Corporations			123,335.33
Capital Stock and Surplus:			
Capital Stock Authorized	5,000,000 Shares		
Capital Stock Issued	2,560,996 Shares		
Less: Treasury Stock	24,535 Shares		
Outstanding	2,536,461 Shares	249,834.73	
Surplus, Capital (Consolidated)		378,157.75	627,992.48
			$898,622.05